SUBMISSION BY THE TORONTO STOCK EXCHANGE TO THE INDUSTRY OWNERSHIP STUDY COMMITTEE OF THE ONTARIO SECURITIES COMMISSION

[Committees]

OCTOBER, 1971

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INDEX OF APPENDICES

1.00

CORRECTION

The word "proving" in 5th line from bottom of page 1 should read "providing".

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The Toronto Stock Exchange is pleased to have the opportunity to submit its position to the Committee of the Ontario Securities Commission constituted to consider the following two questions:

(1) The capital requirements of the investment community and the sources of available capital, including public financing;

(2) The problems inherent in non-resident ownership of securities registrants.

1. Historical

Both these questions have been widely discussed in the securities industry and the policies on both points have had a long history in Canada.

All the major self-regulatory bodies in Canada, including The Toronto Stock Exchange, the Montreal, Canadian and Vancouver Exchanges and the Investment Dealers' Association of Canada have for years had a policy that all shareholders and partners of their member firms must be approved persons. One factor taken into account in the granting of such approval has been the individual's experience in and connection with the securities business. A consequence of the policy has been that, with some minor exceptions, member firms have not been permitted to have non-industry investors.

This policy has been consistent with the policy of the Provincial regulatory authorities. To the best of our knowledge the Ontario Securities Commission has granted registration to only one securities firm dealing with the public which has public shareholders. In that case, all the voting shares are held by persons directly in the business and cannot be transferred without the consent of theCommission. This firm does not carry on a general securities business.

The question of non-resident control of member firms has also been considered over a long period in Canada. The first non-resident controlled Member was admitted to The Toronto Stock Exchange in 1920's. Between that date and the mid-1940's five more non-resident controlled Members, having their principal bases of operations outside Canada, were admitted. During the 1951-1952 fiscal year of the Exchange two such firms were admitted. At that date the Exchanges in Montreal had two such member firms which were not members of The Toronto Stock Exchange. Thus, in total there were ten such non-resident controlled firms which were members of Exchanges in Canada.

In early 1952, Bache & Co. applied for membership in Toronto. At the annual meeting of Members of the Exchange in May, 1952, the Board of Governors sought the opinion of the membership on what policy should be applied on applications for membership by non-resident controlled firms having their principal base of operations outside Canada. A resolution was passed at that time providing that no more than eleven seats on the Exchange should be held by firms having their chief place of business outside Canada. While the minutes of the meeting do not disclose how the number of eleven was determined, it appears clear that it was composed of the ten existing non-resident firms and Bache whose application was then pending. In July 1952, Bache & Co. was admitted to membership.

The policy that no additional non-resident controlled firms having their principal base of operations outside Canada should be admitted was also adopted by the Montreal Exchange. Since that date, the total number of non-resident firms on both Exchanges remained constant until 1970 when White Weld & Co. became a member of the Canadian Exchange. In 1969 Astaire Taylor became a member of the Montreal Exchange. While effective control of this firm lies with non-residents, its principal place of business is in Canada. Non-resident firms which enquired about admission to The Toronto Stock Exchange in recent years were advised of the 1952 policy and that all membership applications were subject to a vote of the members who had established the policy.

The question of non-resident ownership again became an active topic for discussion in early 1969. In May 1969, the Exchange was advised that Merrill Lynch, Pierce, Fenner & Smith Incorporated proposed acquiring another Member firm, Royal Securities Corporation Limited. This acquisition did not increase the number of non-resident Member firms and appeared to come within the policy adopted in 1952. The acquisition did, however, raise the question whether that policy was still appropriate having regard to the expansion of non-resident control which was obviously possible under the existing policy.

At the same time a discussion began to develop in the United States as to the desirability of public ownership.

The Toronto Stock Exchange considered that these two problems should be carefully considered and actively participated in the establishment of the "Moore Committee". The members of the Moore Committee were from across Canada and, with the exception of the Chairman, are actively engaged in the securities industry. The Chairman was Mr. Trevor Moore, who was not so engaged, but who did have very substantial experience in the industry and in financing capital projects in Canada. Its Report was issued in May, 1970, and contained recommendations on both issues. Copies of that Report have been filed with the Commission.

The Report was circulated to all the Members of the Exchange. Following this there was a meeting of the Members of the Exchange to discuss the Report and its implications for the industry.

Subsequent to this meeting of members, the Toronto, Montreal, Canadian and Vancouver Exchanges and the Investment Dealers Association of Canada, who had sponsored the Report, each undertook to consider the Report and to appoint representatives to a committee to recommend whether the Report should be adopted or amended. Pending the receipt of this recommendation all bodies agreed to abide by the recommendations of the Moore Report until at least October 1, 1971.

The representatives of the participating institutions who became known as the Joint Committee, arrived at a consensus after numerous meetings and made recommendations to their respective bodies. The Joint Committee recommended that the conclusions of the Moore Report should be adopted subject to the modifications outlined in Appendix "A".

The Joint Committee's recommendations were distributed to the memberships of the participating institutions with a request for comments. In addition, those members who might be particularly affected by the recommendations were offered an opportunity to appear before the Committee and to express their views in detail. Several of these members availed themselves of this opportunity.

After considering all the representations received, the Joint Committee amended its recommendations and re-submitted them to their governing bodies. All these bodies adopted the amended recommmendations. The sections of the recommendations as amended are attached as Appendix "B". The formal steps required by The

Toronto Stock Exchange to implement the Moore Report and the amending recommendations have not been taken, largely because of the formation of your Committee.

2. Public Ownership

Exchange Proposal

A. The Exchange submits that Members of the Exchange should be permitted to obtain additional capital from outside investors, either in the form of

(a) equity stock; or
(b) debt instruments

The Exchange submits that if such outside financing is permitted it should be subject to the safeguards and restrictions recommended in the Moore Report (Pages 100-104). Briefly, the Moore Committee has recommended that:

(a) No more than 40% of the capital of a firm, including for this purpose "subordinated debt", should be held by outside investors;

(b) All outside investors, other than outside lenders such as banks making loans in the ordinary course of business, should be approved persons with such approval being based on an individual's integrity and not on his experience;

(c) All such outside investors should be individuals, except for non-resident securities firms dealing with the public;

(d) There should be three dollars of equity capital for each one dollar of "subordinated debt";

(e) "Subordinated debt" from outsiders would be required to have a fixed term of at least two years;

(f) The maximum percentage of participating securities and of voting securities to be held by approved outside investors should at no time exceed 25% and outside investors should not have the right to elect in excess of 25% of the members of the Board of Directors or to represent in excess of 25% of the votes to be cast at any election of directors;

(g) No outside investor should hold in excess of 10% of the participating or voting securities of a firm;

(h) Initially no more than 25 persons should be approved as outside investors in any firm.

Such a method will permit the regulatory bodies to know and approve the persons who own equity shares in securities firms and who provide such firms with capital other than that provided by lending institutions in the ordinary course of their business. It will also permit the retention of the principle developed over many years that the control of a securities firm should rest with the persons who are actively engaged in the actual business.

Relevant Factors in Considering Desirability of Capital Sources

B. It is the submission of the Exchange that a method of raising capital for the industry should not be adopted unless that method is clearly consistent with the public interest. It is our submission that

(a) The industry should be strong and financially viable so that it may maintain the confidence of the investing public in its ability to discharge its financial responsibilities;

(b) The industry should be free of improper outside influences which could lead to an

instability in the market place and which would destroy the trust and confidence so necessary to an acceptable broker/client relationship;

(c) The industry should be free of all unnecessary conflicts so that it is able to serve its clients on a professional basis and discharge the obligations which arise whenever one is engaged in the business of giving advice to another;

(d) The industry should be one in which there is a relative ease of entry, subject only to the desirability of having participants who will serve their clients with the integrity which the broker/client relationship demands;

(e) There should continue to be opportunities for persons to enter the industry who will provide varying types of service to their clients;

(f) The public is better served by a relatively large number of participants than it would be if the number of firms were drastically reduced;

(g) The public interest is best served by a continuation of the system by which the persons in control of securities firms must have the continuing approval of the self-regulatory bodies and of the Securities Commission;

(h) The industry should be controlled by persons who have the qualifications and experience required to give good management to a highly volatile industry;

(i) It is desirable that the industry be one which can be closely regulated by the self-regulatory bodies and the Securities Commission, as it has been in the past, having regard to the important obligations which its members must undertake as financial intermediaries.

Exchange Proposal Will Meet Capital Needs

C. It is the submission of the Exchange, based on its experience, that the Members of the Exchange will be able to raise sufficient capital by using the method recommended by it.

The present policy of the Exchange does not permit non-industry persons to own equity shares in member firms or to participate in the profits thereof. Until recently, except in very limited cases, subordinated loans from non-industry investors have not been acceptable.

In January this year the Exchange announced that pursuant to the recommendation in the Moore Report subordinated loans would be acceptable if made from approved non-industry investors. (See Notice to Members No. 761 - Appendix "C").

This change in the acceptability of loans from non-industry investors together with the ability of firms to seek equity capital from approved non-industry investors greatly expands the ability of member firms to increase their capital base. A Member firm can increase its capital by two thirds. For example, a Member firm which presently has $3 million in capital can under the Moore Report, go to $5 million in capital by obtaining $2 million from outside investors.

The Exchange is unaware of any capital needs which could not be satisfied by resort to this method. The Exchange also submits that the use of this method will permit the industry to achieve the objectives referred to earlier; it is the view of the Exchange that a less restricted resort to public financing will endanger the attainment of these objectives.

Present Use of Capital Employed in the Industry

D. There is no need known to the Exchange for any substantial increase in the capital available to its

Members.

Capital For Brokerage Purposes

Of the total capital employed in the securities industry the largest portion is needed for brokerage activities involving transactions effected in the capacity of an agent for a client. The value of shares traded on The Toronto Stock Exchange increased from $1.860 billion in 1959 to $5.765 billion in 1969. The value of trading doubled between 1966 and 1969, rising from $2.877 billion to $5.765 billion. This very substantial increase in trading was financed by using the existing methods of financing. It is noteworthy that the percentage increase in the volume of trading from 1966 to 1969 on The Toronto Stock Exchange exceeded that of the New York Stock Exchange.

The Exchange in its regulatory capacity is familiar with the business operations of its Members and so far as it is aware a shortage of capital was not the cause of any difficulties, which could have endangered the public, experienced during this period of very marked increases in trading.

The experience of the industry does not indicate that the capital needed for brokerage activities will increase on a regular basis. There have been very marked fluctuations in trading. For example, the value of trading fell from about $5.765 billion in 1969 to $3,653,783,248 in 1970. The value of trading fell from $1.860 billion in 1959 to $1.223 billion in 1960. These substantial fluctuations in trading, resulting in substantial fluctuations in the need for capital, did not give rise to any major difficulties affecting the public interest and the financial stability of the business.

Capital For Under-writing Purposes

It is very much in the interest of the Province of Ontario and, indeed, of Canada that the industry have sufficient capital for underwriting purposes. The amount of capital needed to undertake this function on a very large scale appears to be surprisingly modest.

The number one underwriter in the United States in 1970 was the First Boston Corporation, which managed underwritings having a value in excess of $7 billion; its net worth was $43 million. Lehman Brothers Incorporated was the third leading underwriter in the United States, being the managing underwriter in underwritings aggregating over $5 billion; its net worth was $32 million. Morgan Stanley & Company Incorporated had a net worth as of December 31, 1970, of approximately $9 million. It was the fifth largest underwriter in the United States, having managed underwritings aggregating over $4 billion. The second and fourth largest underwriters have substantially greater net worth, but they were engaged in a much more diversified securities business, including a substantial brokerage business.

(See "Finance" July, 1971 - Pages 12-15 inclusive)

Capital For Liability Trading

Some brokers are also engaged in liability trading which creates a further need for capital. Liability trading has been permitted by The Toronto Stock Exchange under varying regulations for a considerable period of time. Nevertheless, liability trading has never constituted a significant portion of the total trading done on The Toronto Stock Exchange. The volume of the "off-the-floor" liability trading reported to the Exchange pursuant to its by-laws has ranged from a high of $54 million in 1967 to a low of $3.5 million in 1970. During the period from 1966 to 1970, inclusive, the greatest volume occurred in 1967 when it accounted for approximately 3/4 of 1% of all the trading done on The Toronto Stock Exchange.

It has been the Exchange's view that the primary function of a broker should be to act as an agent for his customer and that liability trading should only be permitted where the market may not provide the liquidity necessary to serve the customer by way of an agency trade. This has led The Toronto Stock Exchange to vary the rules as to liability trading as its experience demonstated that there was a need for more or less liability trading.

The conditions under which liability trading may now be done on The Toronto Stock Exchange are less permissive than they were in the year 1967 when the volume reached its peak. Accordingly, it seems most unlikely that the demand for capital for this purpose will, in the near future, exceed the capital demand in 1967. The Exchange has no information which would indicate that the industry did not have sufficient capital to serve the demand for liability trading at that time.

It is stated, at page 541 of Volume 4 of the Institutional Investors Study Report of the Securities Exchange Commission, that liability trading increased from 2.1% of the transactions conducted on the floor of the New York Stock Exchange in the year 1964 to 14.8% in the year 1970. It is impossible to tell from this study what capital was required by the firms to finance this undertaking. At page 1608 it is indicated that by the end of the first week 56% of such securities were still held by the brokers; at the end of two weeks 36%; and at the end of thirty days 7%.

The Toronto Stock Exchange, as indicated earlier, wishes liability trading to be done only in cases where the client's interest cannot be satisfactorily served by an agency transaction. Accordingly, in assessing any claim that further capital is needed for liability trading, it is submitted that care should be taken to distinguish between capital which is needed to permit a firm to carry out a liability trade and capital which might be needed to permit a firm to hold the securities, which were originally the subject of a block trade, beyond the time when a disposition might reasonably be made of such securities in the market.

It is submitted that entirely different considerations arise in cases where a firm wishes to use a substantial part of its capital for the purpose of taking a relatively long term position in the market than arise in cases where capital is to be devoted to liability trading which has as its objective rather short term transactions in securities. There is no doubt that the financial position of a firm can be adversely affected if it is heavily engaged in rather speculative long term positions in securities. It is suggested that careful enquiry would need to be made as to whether it was in the public interest to facilitate the raising of capital for this purpose.

Capital For Money Market Transactions

Some Members also engage in the money market and the market for Government securities. However, the amount of capital required for this does not represent a significant amount of the total capital employed by the industry and, so far as the Exchange is aware, the need for such capital in the Canadian market is presently being adequately served. By far the greatest part of the money utilized in performing this function is provided by bank borrowings on a day -to-day basis.

The money market operations of member firms on the Exchange have increased substantially in the last several years. The Member firms only commenced to carry on money market operations in 1954. In 1971, the money market component of Members' call loans was over $400 million at one point during the year. There is also a substantial fluctuation in the volume of this form of trading from month-to-month. In 1971 the money market component of Members' call loans has varied from $281,263,335 to $409,174,278.

The investigation conducted by the Moore Committee revealed that 25% of the capital used by the firms reviewed was used for all dealer activities, including underwriting, money market activities, dealer activities in secondary markets and in positioning.

The regulations of the Investment Dealers' Association relating to the margin required for money market operations are set out in Appendix "D". They indicate the relatively small amount of capital required to carry on money market activities, which ordinarily involve only very short term positions.

Capital For Diversification

There have been suggestions made that securities firms might be permitted to raise more capital for other activities, such as real estate transactions and other transactions which are not a part of the business of financial intermediaries. The Exchange questions whether the financial stability of the industry will be aided if firms diversify in this way. In Canada, securities firms have been engaged almost exclusively in the business of acting as financial intermediaries. It seems to the Exchange that any departure from this practice raises serious problems involving the public interest which should be determined apart from this hearing.

Capital For Equipment and Facilities

It is the view of the Exchange that other capital needs of the industry, such as its need for new equipment and facilities, could be adequately met by resort to capital sources which the Exchange's recommendation will permit. It is the view of the Exchange that the needs of the industry for additional equipment are likely to be better served by resorting to a pooled use of such facilities or to the rental of such facilities, rather than by substantial acqusitions by individual firms of very expensive equipment in a field where the technology is changing very rapidly.

Adequacy of Existing Methods of Raising Capital

E. The methods used in the industry to raise capital have been in common use in Canada, the United States and the United Kingdom for a long period and have provided the industry in these countries with the capital necessary to conduct the business. The existing methods should only be abandoned if they have proved unsatisfactory or have failed to provide the industry with the necessary capital. The Canadian securities firms have been able to expand their capital very substantially by use of the existing methods. Returns from 114 securities firms operating in Canada show that they employed $100.4 million of capital in 1965 and that by 1969 this had increased to $155.4 million. Such a substantial increase does indicate that the existing methods of financing have permitted a substantial increase in the amount of capital employed.

Comparison of New York and Ontario Capital Needs

F. In assessing the need for capital it is relevant that members of the New York Stock Exchange were able to develop the largest trading volume of any Stock Exchange in the world without resorting to any form of public ownership until very recently. The members of the New York Stock Exchange approved public ownership following severe difficulties in the industry and at a time when the industry was under great strain. It may be too early as yet to make a definitive assessment, but it does seem apparent that the difficulties were not caused primarily by a shortage of capital, but rather by inadequate management and in some cases an imprudent use of existing capital. Fortunately, the Ontario industry is under no similar compulsion to alter so radically and swiftly its methods of financing.

The difficulties in New York have no parallel in Canada. Goodbody & Co. was the sixth largest member of the U.S. investment banker broker group with a net worth in 1969 of about $63 million. Francis I. Dupont was the eighth largest, Hayden Stone was the seventeenth largest and Dempsey Tegler was the nineteenth largest. Dupont had a net worth in 1969 of $60 million, Hayden Stone of approximately $39 million and Dempsey Tegler of approximately $36 million. Thus, of the twenty largest U.S. firms in terms of net worth in the year 1969, one-fifth either failed or were required to be merged or suffered major financial difficulties leading to a complete change of control. During the period 1969 to 1970, the New York Stock Exchange interfered directly in the affairs of nearly 200 member organizations — more than half the total number of firms dealing with the public.

It is perhaps impossible to determine the reasons for this traumatic experience among the New York firms. Nevertheless, the material which is now available does indicate that the difficulties were caused by (a) improvident use of capital; (b) a failure on the part of management to maintain adequate controls of its business;

(c) a method of financing by way of subordinated loans which is not permitted under the regulations in effect in Ontario.

Under the procedures permitted by the regulations of the New York Stock Exchange it was possible until 1970 for investors of a New York firm to demand payment of their subordinated loans on relatively short notice. This meant that when a firm was in financial difficulties the inside group could require a return of their subordinated capital. Under the practices of The Toronto Stock Exchange no subordinated capital may be withdrawn without the approval of the Exchange Auditor, and each creditor is bound to honour the decision of the Exchange Auditor. Under no circumstances has this approval ever been given if the effect was to reduce the capital of a member firm below the net free capital requirements of The Toronto Stock Exchange. In addition, no Member is permitted to redeem its capital without the approval of the Exchange which is not given unless the Exchange Auditor is satisfied that such reduction will not impair its capital position. The New York Stock Exchange did not have a comparable requirement.

As a matter of practice The Toronto Stock Exchange had very rarely approved of the subordination of securities other than Government Bonds. Evidently, this practice was permitted by the New York Stock Exchange with the result that any lessening of the market value of such subordinated securities could lead to a capital problem for the firm and, in fact, did lead to serious problems during the declining market in 1970.

Accordingly, the practices by which The Toronto Stock Exchange permits Members to use subordinated loans and subordinated securities in lieu of equity capital are entirely different from those employed by the New York Stock Exchange. The objective of The Toronto Stock Exchange was to have subordinated loans made on a basis which would secure permanency of financing. The Exchange has control over the timing of the withdrawal of any such funds.

The margin maintenance requirements and the inventory margin requirements in New York are less onerous than those in Toronto. There is some difficulty in comparing the capital requirements of The Toronto Stock Exchange and the New York Stock Exchange because in some cases the methods of computation differ. However, despite these differences the requirements of The Toronto Stock Exchange as to capital were at least as onerous as those of the New York Stock Exchange.

In part at least the much more stringent attitude by the self-regulatory bodies to the use of loans by insiders may be partly responsible for the much better performance by the Ontario industry than the performance of the New York industry. Undoubtedly, there is a need for the American firms to adopt a system of financing which will provide them with much more permanence in their capital arrangements than the subordinated loan system which they had adopted. It does not follow that it is necessary to use equity capital raised from the public generally instead of subordinated loans for the purpose of obtaining the required permanent capital in the industry or to have wide public ownership not permitted by the Moore Report.

Need For Financing on a More Liberal Basis Should be Demonstrated to be in the Public Interest

G. The Exchange also submits that any change in the present method of financing which would result in public trading of the shares of member firms should only be made if -

(a) It can be clearly demonstrated that there is a real need for financing of this kind; and

(b) The public interest will be served by such financing.

Such a change should not be based on unsubstantiated assumptions as to a need for capital or speculation as to capital needs which are not capable of demonstration at this time.

The Exchange's experience indicates that the difficulties of member firms are ordinarily caused by the manner in which they manage their resources, rather than the lack of capital.

It is also submitted that it would be unwise to abandon a system permitting close supervision and control for a system permitting a general resort to public financing which, in the opinion of the Exchange, will undoubtedly lead to an inability of the regulatory authorities to know the persons who can control the industry.

Our reasons for the Exchange's position as to public ownership are set out in greater detail in the ensuing paragraphs.

Enquiries as to Need for More Liberal Methods of Raising Capital

H. If there is any need for more capital than the method proposed by the Exchange would provide, then it is submitted that the need should be demonstrated clearly. In particular -

(1) It should be established that firms are being handicapped in undertaking securities business by an actual lack of capital and that any new method of raising capital will satisfy this lack of capital;

(2) The uses for the additional capital should be demonstrated so that the Commission may determine whether the capital is to be used for an existing business or for some other purpose. The use for the additional capital should be clearly identified so that the Commission may determine whether the capital is to be used for the securities business or for some other purpose. It is submitted that if the capital is to be used for purposes other than financing the securities business, fundamental questions arise as to whether the public interest will be served by such a diversification. It is submitted that if capital is required for purposes other than financing the securities business, then such need is really irrelevant to the question as to whether further capital is required for the securities business;

(3) The types of firms needing capital should also be examined and their particular needs identified;

(4) Enquiries should be made as to whether any firm has been compelled to reject business because of a need of capital.

It is also submitted that in examining any suggestion that public financing is required, care should be taken to distinguish between the sale of securities to the public to realize additional capital for a particular firm and a sale of already outstanding shares to the public which will yield no additional capital to the firm. It is submitted that entirely different considerations arise in determining the desirability of permitting these two different types of transactions. The second of the two types of sale raises no new capital for the firm and therefore the argument that the industry needs additional capital is irrelevant in assessing the desirability of this type of sale. Having regard to some of the disadvantages which may result from the public trading in the shares of securities firms, it may be undesirable to permit a sale of such shares to the public unless it leads to further capital being made available for the securities firms.

Need to Transfer Equity Shares at Book Value by Persons Presently Actively Engaged in the Business to Their Successors

I. Most of the firms in the industry have a system by which ownership is transferred from persons retiring from the business to younger persons active in the business at a price representing book value or some figure approaching book value. This has meant that the persons actively engaged in the business have been able to maintain a substantial equity interest in it. If firms issue shares to the public on a "times earnings" basis and at a substantial mark-up over book value, it will be much more difficult for the younger persons actively engaged in the business to maintain control over the business.

The turn-over problem was dealt with at length in the Moore Report (pages 56 - 57). It is the view of the Exchange that the problem can be met with the method of financing proposed by the Exchange. The problem appears to be primarily a matter of proper planning by the firms involved. It is the view of the Exchange that the industry should be controlled by those actively engaged in it and that this objective is only to be attained by continuing the practice of valuing the shares of securities firms at prices ordinarily based on book value, rather than by resorting to a higher times earnings price.

Importance of Identifying Controlling Interests in Securities Firms

J. The Exchange has found, as a result of its experience over many years, that it is important to know the persons involved directly or indirectly in the conduct of the securities industry and to determine whether they may be entrusted with the fiduciary obligations inherent in their operations which are almost akin to a professional service. The long standing practice of knowing the persons in control of the Member firms should not be abandoned unless there is a pressing necessity to do so.

Importance of Supervision of Persons Operating Securities Firms

K. The history of the securities business during the last forty years has been characterized by a continual increase in the supervision exercised by regulatory authorities. This increasing emphasis on regulation is accounted for probably by the opportunities which exist in this industry for unscrupulous persons to profit at the expense of the public.

It has been said in a review of the securities industry by Sidney Robbins, entitled "The Securities Markets - Operations and Issues", that "In the pre-S.E.C. era the securities markets were a jungle of deception and manipulation. It was estimated, for example, that during the first decade after World War I, fully half of some $50 billions worth of new securities floated in the United States became worthless. Such a mass collapse of values occurred because of the complete abandonment by many underwriters and dealers of standards of honesty and fairness. The orgy of speculation which had existed in the stock market, coupled with the fraud, manipulation and other malpractices then prevalent, could lead only to disaster." (page 106)

The disaster occurred in the year 1929. In the aftermath of that disaster investigations disclosed that its cause could in no small part be attributed to a lack of supervision of the conduct of the persons engaged in the industry. The result was the enactment of legislation which made the securities industry probably the most supervised and closely regulated industry in the world. The years since then have been marked by a development of more regulations and by even greater concern with the probity of the persons who are in a position to act as financial intermediaries and to influence the public market in securities. Experience demonstrated that the opportunities for gain at the expense of the public called forth the ingenuity of unscrupulous persons. This led to continuous responses by the regulatory authorities. The result was that under these regulations confidence in the market was restored and the U. S. securities industry, generally speaking, performed a very useful function in serving the public interest.

Similar developments have occurred in Canada. In some cases our regulatory problems have differed from the United States because of the differing demands of the capital markets here. It can be fairly said that a very substantial number of the cases when the public has suffered because of a failure of a firm engaged in the securities business can be traced to a lack of responsibility of the persons involved. Our most recent experiences in Canada only serve to underline the need for effective regulation of those in a position to influence the conduct of securities firms.

Recently, difficulties have been experienced in the securities markets of the United States. These difficulties

in many cases were caused by inadequate management on the part of those operating securities firms, excessive speculation, or by a breakdown in the enforcement of the regulatory procedures. One consequence has been that investigations are now taking place in the United States to consider whether further regulations should be enacted.

It is the judgement of the Exchange that the experience of regulatory authorities over the last forty years indicates quite clearly that it is vitally important for the regulatory bodies to know the persons who are in a position to influence the activities of financial intermediaries in the securities industry. Certainly, all of the problems in the securities industry cannot be attributed to difficulties in this area, but the experience of the industry does indicate that difficulties will occur if the industry is not safeguarded against the control of its member firms falling into unidentified hands. Many of the difficulties which the industry has had can be attributed to persons who were not within the scope of the regulatory authorities but had power to influence the conduct of firms and of the market place. In considering the problem of outside influence it is important to consider the influence of persons who have provided substantial amounts of outside capital in the form of debt. Unless the provision of this capital is closely supervised, abuses can occur.

It is submitted that the type of regulation which has developed in the securities industry differs very substantially from the type of regulation which is found in most other industries. In response to the abuses in the industry there has been a continuing and increasing emphasis by regulatory bodies on the need to know the persons engaged in the industry and to evaluate their competence and probity. It may be that this type of regulatory system has developed in this industry because it is perhaps easier to manipulate a public securities market to the disadvantage of the public than it is to operate any other business with such drastic results from the public point of view.

The experience in the industry has led to greater emphasis being placed on the supervision and approval of participants in the industry than in any other industry. Indeed, the extent of supervision over the probity of the participants in the industry is undoubtedly greater than that found in most of the professions.

Therefore, the Exchange submits that any step which will make it more difficult for the regulatory bodies to identify the forces capable of influencing the conduct of financial intermediaries will render the regulatory process more difficult and will serve to weaken the protection which will be given to the public.

The Exchange believes that the scheme favoured by it, which would permit a firm to increase its capital by two-thirds, would serve the capital needs of the industry while preserving the principle that those in control of a firm should be known to and approved by the regulatory authorities.

Ability to Supervise those in Control of Securities Firms When Shares are Publicly Traded

L. The Exchange does not believe that adequate information may be obtained as to the control of a securities firm when its shares are publicly traded. Information as to the beneficial ownership of shares will be difficult to obtain once knowledge of that ownership is no longer held by a relatively small number of persons who are known to the regulatory bodies and subject to their jurisdiction.

The relative size of Canadian securities firms makes their possible acquisition by persons who might wish to exercise control for an improper purpose much more likely than the acquisition of companies engaged in other financial businesses which usually have a much greater net worth.

Difficulties of Ensuring Responsible Control of Smaller Firms

M. The size of Canadian securities firms in comparison with that of the U. S. firms which have gone public makes the problem of ensuring their freedom from improper control much greater than would be the case

with the American firms. This problem would be compounded with the members of other Exchanges because these firms tend to be relatively smaller than the members of The Toronto Stock Exchange. The problem is compounded even further with non-member broker-dealers who tend to be smaller again.

Problems in Imposing Sanctions on Publicly Controlled Firms

N. It is submitted that it is easier for the regulatory bodies to impose sanctions on the firms when those firms are controlled by persons actively engaged in the business or persons who clearly recognize the risks involved. It will be more difficult to penalize a member firm by suspensions and other disciplinary actions when the consequences of such actions will fall most heavily on public investors who had no involvement or real ability to influence the acts which led to the disciplinary action.

Public Trading of Securities of Investment Firms Could lead to Substantial Concentration

O. The Exchange presently has 97 Members. It is considered that the public is better served by having a substantial number of participants in the business than it would be if the number of participants was materially lessened. It seems obvious that only a relatively small number of firms would be in a position to market their own securities to the general public. If this proves to be the case, such action will undoubtedly result in a concentration in the securities business which is likely to be undesirable. Accordingly, the need for the sale of shares to the public should be clearly demonstrated before any such action is taken. In 1951 there were 94 Member firms, as compared with 97 Member firms today. In these 20 years, however, 46 Members ceased to exist and 49 new Members joined the Exchange in the period. In the decade between 1961 and 1971, 34 Members ceased to exist and 31 new Members joined the Exchange.

This substantial change in membership illustrates that newcomers have little difficulty in establishing themselves in the industry, provided that they can meet the tests of the regulatory authorities. During the last 20 years the industry has seen the disappearance of many firms who for one reason or another failed to meet the altering needs of the investment public. In this period there has also been a substantial number of new entrants who have been able to attract the financing necessary to become viable and strong competitors in the business.

The changing membership may perhaps be explained in part by the fact that the competence of individual members of a securities firm is often the greatest attraction which such firm can offer to its clients. Accordingly, people who are highly competent can, if they wish, commence a business of their own and obtain the required capital to do so.

Disclosure by Publicly Owned Firms

P. If securities firms are permitted to issue securities generally to the public, problems will arise as to the disclosure of the affairs of those companies which should be made to their shareholders. In many cases such firms undertake responsibilities for clients which require absolute secrecy. On some occasions the firms may obtain substantial earnings from such activities.

The existence of a responsibility to disclose matters to the public which, although they may have a most material effect on the earnings of a securities firm, relate to the confidential affairs of clients, is, it is submitted, inconsistent with the professional obligations as to secrecy and confidence which a broker should have to its client. On occasions, the obligations which the law imposes on companies as to disclosure to shareholders may conflict with the professional obligations which a broker has to its clients in its fiduciary relationship with those clients. This is particularly relevant in cases where individual transactions conducted by brokers may have a very material effect on their earnings and where a premature disclosure of those transactions could cause irreparable harm to the client.

Desirability of Professional Standards

Q. As has been stated, the securities industry is highly self-regulated. This self-regulation has been

encouraged through legislation and by the regulatory bodies of Government. This type of self-regulation is characteristic of activities which require high standards of professionalism. It is not characteristic of professional associations to permit their members to have public shareholders. It is illogical for professional firms to be subject to the control of non-professional people.

It is the goal of the Exchange to encourage the growth of the concept of professionalism within its membership. It is the view of the Exchange that in this manner the Members of the Exchange can best resolve the complex problems that confront them in acting as financial intermediaries.

Will Public Trading in the Shares of Securities Firms Lead to Greater Stability in the Industry?

R. It is submitted that the securites industry will not be aided by a public marketing of securities if the earnings of the securities firms prove to be volatile and the price performance of the security proves to be equally volatile. It is submitted that the experience in the United States is not relevant because the Canadian firms are substantially smaller than their counterparts in the United States. The U. S. firms presently carrying on business in Canada and firms which are controlled by Americans had an aggregate net worth in 1969 of $595 million which is approximately $400 million greater than the total net worth of all of the Canadian owned firms in that year. The net worth of one non-resident firm alone is $304 million.

There is no doubt that the earnings performance of even the largest firms may be highly volatile. Bache & Co. a firm with a diversified business, which in 1970 had a net worth of $99 million had a loss of $9.7 million in the first quarter of 1970. By the second quarter it had come to a break-even position and by the third quarter it showed a profit of over $1 million. In the previous year it had a pre-tax loss of $8.7 million and its Chairman said that in that year cost cutting efforts simply did not begin soon enough. "It takes time before people realize, before the lessons begin to sink in". (See Fortune December 1970.)

It is apparent from what has been written about some of the New York experiences that the events of 1969 made it virtually impossible for the existing firms, with some of their accounting practices, to determine what their real position was. Accordingly, earnings statements by such companies might provide much less than adequate information for the investor.

The earnings records for the years 1964 to 1970 of some of the leading New York Stock Exchange members which have filed registration statements with the Exchange are set out in Appendix "E" and illustrate the volatility of the earnings of such firms. The price performance of the shares of the New York Stock Exchange members which have gone public is set out in Appendix "F". It is evident that there has been a very wide fluctuation in the price of these securities.

It is submitted that the problems inherent in the marketing of equity shares of securities firms differ materially in Canada from those which may be encountered in the United States. Under the listing requirements of The Toronto Stock Exchange a firm must have net tangible assets of $1 million. The market value of issued shares in the hands of the public must be $1 million. There must be a public distribution of a minimum of 200,000 shares which shall be held by at least 300 public shareholders, each holding a board lot or more. The vast majority of the Members of The Toronto Stock Exchange would not have net tangible assets of $1 million. Furthermore, if any substantial holdings of the shares of such companies were to be retained by the persons engaged in the business, there would be few companies which would be able to have a public issue with a market value of $1 million in the hands of the public.

Experience has shown that difficulties can be encountered in providing an adequate market for the

securities of a company which has only the minimum number of shares listed in the market; particularly if the earnings of such company are volatile.

The problem of providing an adequate secondary market is compounded if the securities are traded in the over-the-counter market. Such a market is generally considered to be less satisfactory than a listed market and prices tend to have wider spreads and be subject to greater fluctuation.

It is submitted that if securities firms are to be permitted to have their shares publicly traded it is most desirable that the performance of these stocks will not jeopardize public confidence in the securities industry. Any unsatisfactory performance of the publicly traded securities of a securities firm will only serve to lessen public confidence in that firm and in the industry.

As previously mentioned, the principal asset of a securities firm is the competence of its personnel and the goodwill that those individuals have established. With securities firms having no other significant assets the price of the securities of firms will depend to a large extent upon the continued presence within member firms of key personnel. This factor will be very significant with smaller sized firms. It is noteworthy that the practice in the industry is for purchasers of firms not to make any payment, or at most only a nominal payment, for goodwill. This practice represents a very realistic assessment of the fact that the persons who make the earnings possible should not be treated as an asset of the firm since they can so readily leave.

It is also relevant that, although the public interest requires that the industry should be stable and command public confidence, its very nature and the changing conditions to which it is subject causes it to have a substantial number of risk factors. It is significant that in the most recent registration statements by securities firms it has been considered desirable to describe these risk factors in detail.

The registration statement filed by Bache & Co. Incorporated contains the following statement -

> "As indicated elsewhere in this Prospectus, the Company and the securities industry are subject to a number of inherent risks. Factors affecting the securities industry as a whole include such uncertainties as the state of world affairs and the national economy, governmental and other regulatory policies and trading volume and price levels in securities and commodities markets.
>
> Volume of trading and price levels in the securities and commodities markets fluctuate widely. Any significant reduction in trading volume on the exchanges of which the Company is a member or in the over-the-counter market could result in lower brokerage commission revenues. Significantly increased volume on the other hand, could result in increased operational problems such as increased fails to deliver and receive, errors in servicing customer accounts and in processing transactions and increased clerical and supervisory salaries and related costs. Price fluctuations could result in losses in the Company's securities inventories and investment accounts.
>
> The securities industry is governed by regulatory bodies which are charged with protecting the interests of the Company's customers in many instances rather than its shareholders. Bache's business is subject to immediate curtailment and even termination if its memberships on securities and commodities exchanges or its broker-dealer registration should be revoked or lesser sanctions imposed.

Recent and proposed changes in regulations governing the securities industry may have an adverse effect on the Company".

These and other risk factors identified in the Prospectus involve the following considerations:

1. Deterioration of operating results in recent fiscal years.
2. Operational problems.
3. Recent history of the securities industry.
4. Commission structure.
5. Net capital requirements.
6. Free credit balances.
7. Use of customers' securities.
8. Mix of retail and institutional business.
9. Litigation.
10. Securities industry hearings and inquiries.
11. Regulation.
12. Underwriting and related risks.
13. Competition.

Every other Prospectus filed with the New York Stock Exchange by its members has emphasized the risk factors inherent in the industry.

Thus, it is submitted that the following factors should be considered in determining whether public trading of the shares of securities firms is to be permitted:

(a) The number of shares which a securities firm is likely to market may not be sufficient to provide an appropriate trading market;

(b) The volatility of the earnings in the industry may well lead to substantial fluctuations in the price of the securities; and

(c) The nature of the industry involves some substantial risks which could lead to marked fluctuations in the price of the securities.

If these factors combine to cause an instability in the price performance of the publicly traded securities of investment firms the confidence of the public in the whole of the investment industry may well be affected.

In view of the recognized elements of risk in the business, it seems preferable that the business should remain in the hands of a relatively small number of informed investors.

Difficulty of Smaller Firms Obtaining Listing

S. Many of the smaller firms would be denied a listing on The Toronto Stock Exchange under the present listing requirements. However, if securities firms are permitted to market their shares to the public generally, very difficult questions will arise as to whether the smaller firms should be denied the use of market facilities when the benefit of those market facilities may give their larger competitors a distinct advantage over them. In any event, if the existing listing requirements were applied to all securities firms, a vast majority of the securities firms would be undoubtedly denied the benefit of a stock exchange listing which does make it easier to market securities.

Difficulty of Marketing a Broker's Shares

T. If the shares of securities firms are to be publicly traded, the traditional function of the broker will be changed very materially if it is permitted to market and trade in its own shares. The conflicts which such marketing and trading would give rise to are legion. The traditional functions exercised by a broker establish, it is submitted, a relationship between the broker and the public which is inconsistent with any right on its part to deal in its own securities or to sell them directly to the public.

If a broker may not deal in its own shares because of the obvious conflicts of interest which are involved and its inability to give dispassionate advice as to the value of such shares, then all such dealings will have to be conducted through its competitors. This places both brokers in a very unusual position. The broker seeking capital must place detailed knowledge of its affairs in the hands of the competitor who will underwrite its securities and who presumably will continue to act as its fiscal agent in connection with the market. The broker marketing the shares will, in effect, be raising funds for its competitor.

This is a situation which has no precedent whatsoever in any normal financing operation. It illustrates the difficulties of permitting such firms to raise money in this way and to abandon their traditional position where they should in all underwriting situations deal with each other at arm's length.

Even when a company issues its own securities directly to the public as a security issuer, the position does not give rise to the potential problems which exist here. A company is not engaged in the business of selling securities to the public or in the secondary trading of its own securities or in giving advice about them.

Conclusion

U. Accordingly, it is submitted that the public interest would be best served by adopting the limited public ownership recommended by the Exchange. If it later proves necessary, in the public interest, to enlarge the methods by which securities firms may raise money from the public, the matter may be considered again. In this way the development of any public financing policy could be carefully planned in response to a well demonstrated need for additional sources of capital and taking advantage of whatever experience is developed in the United States and elsewhere.

3. Non-Resident Ownership

> Under what circumstances and upon what terms should existing registrants who now exceed the allowable limits be required to reduce their non-resident ownership to the levels established for new applicants?

Policy Should be Directed Towards Achievement of Goals Expressed by Prime Minister

A. It is the view of the Exchange that the policy adopted as to existing non-resident ownership should be consistent with the objectives of the Government as announced by the Prime Minister on July 13, 1971. In his statement the Prime Minister said -

(a) "one very large and critical area to the firm establishment of Canadian determination is the investment community;

(b) the investment community must be responsible and responsive to the particular needs of Canada. Its owners must be amenable to these needs and aspirations;

(c) we believe it to be essential that ownership of investment companies remain substantially Canadian".

The Prime Minister requested the Ontario Securities Commission to examine the question of "the continuing status of existing registrants which are foreign controlled". In the debate, the Prime Minister did

indicate that over a period of time action would be taken to deal with the existing firms which did not comply with the policy (Hansard, July 13, 1971).

The Exchange believes that the goals enunciated by the Prime Minister are most likely to be attained if all investment firms in Ontario are eventually governed by the general rules as to Canadian ownership established by the Prime Minister.

Existing Non-Resident Firms May Substantially Expand Foreign Share of Securities Business

B. If the existing non-resident firms do not ultimately become Canadian owned, then a number of problems may arise in attaining the objectives stated by the Prime Minister. At the moment, the non-resident firms do not have a substantial share of the Ontario business. However, their resources far exceed the combined resources of the Canadian firms(Moore Report,pages 15 and 157). Accordingly, it would be possible for them to expand their share of the Canadian business substantially, without materially affecting their overall earnings position. If such an expansion does occur, it will be even more difficult at a later date to seek substantial Canadian control of the business.

Further Expansion of Non-Resident Share of Business is Inconsistent With Government Objectives

C. Therefore, if the non-resident firms are permitted to continue their operations in Canada without any incentive to seek Canadian partners and without any limitation on their expansion, it is entirely probable that they will be able to expand materially their existing share of the business. It is submitted that such an expansion is not consistent with the objective of the Government that ownership of investment companies should remain substantially Canadian. If the American firms are able to use their very substantial resources to expand their Canadian business there is little doubt that their share will increase greatly, if they choose to increase it.

As the Government has concluded that the industry should be substantially controlled by Canadians, it is submitted that action to deal with the problem of the expansion of the foreign sector by the existing non-resident controlled firms must be taken now. It will be very difficult ever to take any action again, if regulations are enacted at this time which permit substantial expansion of the foreign sector. After such expansion occurs, the foreign firms could well take the position that the Government, having developed regulations to give effect to the public policy on Canadian ownership, must have been willing to countenance whatever expansion of the foreign sector the non-resident controlled firms could achieve by use of their very large resources. Therefore, it is submitted that, having regard to the very real capacity of the non-resident firms to expand their share of the Canadian business, steps should now be taken to ensure that the established public policy will be effective.

Legislative Action in Other Industries to Secure Canadian Control

D. The experience of the Federal government in its legislation regarding the periodical industry is instructive. The legislation made no provision for a roll-back of the ownership of such magazines as Time and Reader's Digest which occupied a dominant position in the field. Despite the policy of the Government, the dominance of Time and Reader's Digest was maintained and their aggregate market share increased. (See Appendix "G"). In the case of the banking legislation, the Federal government imposed restrictions on the expansion of the Mercantile Bank so that its further expansion in Canada would be dependent upon an expansion of Canadian ownership. (See Section 75 (2) (g) of the Bank Act). The approach taken to secure Canadian ownership has differed from industry to industry. (See Appendix "H").

Action to Secure Canadian Control of Securities Industry Should be Designed Particularly For It

E. It is submitted that in determining how substantial Canadian control of an industry may be achieved, it is important to consider the organization and problems of the particular industry. The methods used in other situations do not necessarily have any application to the securities industry. Rather, the objectives established by the Prime Minister should be achieved by methods which are designed particularly for the circumstances of this

industry and which recognize the possibilities for expansion of the foreign sector of this industry.

In the absence of some formula to restrict the expansion of the foreign sector of the industry, the objective of the Government, it is submitted, will be defeated. The Exchange does not believe that it is necessary to limit the expansion of any securities firm to secure this objective. Rather, it believes that such expansion should be made by the introduction of Canadian capital into non-resident firms.

Use of Retained Earnings by Non-Resident Firms

F. If non-resident firms are permitted to use the whole of their retained earnings as the base for further expansion, their participation in the industry may be greatly expanded. Retained earnings have always constituted a substantial source of financing for foreign firms carrying on business in Canada. Of all Canadian companies having assets over $5 million in the years 1962 - 1966, inclusive, 46% of all additional funds raised were generated from internal earnings. Only 17% of the funds raised were generated from external sources reflecting equity investment. Thus, by far the largest source of new shareholders' equity is represented by retained earnings.

American subsidiaries rely more on internally generated funds than is average. The April-May, 1971 Monthly Review of the Bank of Nova Scotia contained the following: -

> "...but direct investmentcan also proceed without any cross-border movement of capital at all, as occurs when foreign corporations increase their control over assets through an investment in kind or a reinvestment of subsidiary earnings. As may be seen in the accompanying table, funds from the United States actually supplied a relatively small proportion of the total financing needs of U. S. controlled companies in Canada between 1963 and 1968. Over 60% of the funds used for the expansion of these firms in the indicated years was, indeed, "internally generated" by the affiliates themselves in the form of retained earnings and depreciation and depletion allowances. Of the "external" supplies of financing coming other than from the United States the most important have been through direct borrowings in Canada, either by security issues, by bank loans, or by short term trade credits."

Of the funds available to U. S. subsidiaries in 1968, retained earnings made up $529 million, depreciation $864 million and funds from the U. S. only $127 million. Funds obtained from Canadian banks and other Canadian sources were $539 million.

Retained earnings are equally important to the investment industry. The Moore Committee survey of the affairs of some 114 firms showed that retained earnings constituted 46% of the total capital of such firms in 1965 and 48% of such capital in the year 1969, which was the last year covered by the survey. The importance of retained earnings can be illustrated by the experience of the First Boston Corporation, which has been able to grow to its present pre-eminent position while using retained earnings as its principal source of permanent capital.

Canadian firms pay out a substantial portion of earnings because these earnings, in many cases, represent the principal source of financing used by younger shareholders to acquire interests in their firms. If the firms are to continue to be controlled by those who are engaged in the business and are to be subject to the direct supervision of the regulatory authorities, this practice must continue. The earnings of Canadian firms from Canadian operations represent, in most cases, virtually all of the earnings available to such firms. The non-resident firms

carrying on business in Canada can more readily add to their Canadian-employed resources by the retention of earnings than can the Canadian firms. The Canadian earnings of the non-resident firms represent only a small fraction of their aggregate earnings so that, if desirable, they will have no problem in the re-application of the whole of these earnings in Canada. In other words, Canadian firms must use their earnings to provide dividends to their shareholders; the Canadian earnings of the non-resident firms do not need to be used for this purpose, but may be used solely for the purpose of financing a substantial expansion of their operations in Canada.

Use of Foreign Borrowings by Non-Resident Firms

G. A problem will also arise if the non-resident firms are permitted to increase the capital employed in the Canadian business by use of foreign borrowings. For example, it would be entirely possible for one of the existing non-resident firms, having substantial resources, to embark on an aggressive expansion program in Canada. Such a program might entail operating losses over a period as the price for acquiring substantial new business but it could be very profitable over a long period and be very much in the interests of the non-resident firm. However, it would also inevitably lead to that firm enjoying a much greater share of the Canadian business. Such a result would be contrary to the objective of maintaining substantial Canadian ownership of the business. To avoid this, it is submitted that some restrictions should be placed on the use of foreign resources by the non-resident firms.

Canadian Control Will Lead to Firms Being Responsive to The Particular Needs of Canadians

H. One of the objectives enunciated by the Prime Minister is that the investment community must be responsible and responsive to the particular needs of Canadians, and that its owners must be amenable to these needs and aspirations. If these objectives are to be attained, it seems important to the Exchange that all firms carrying on the investment business in Canada should, over a reasonable period, become controlled by Canadians. In this way all such firms will be amenable to the needs and aspirations of Canada and will be subject to the primary jurisdiction of Canadian governmental authority. In this way these firms may be made completely responsive to the fiscal and other needs of Canada.

Canadian Industry Should be Subject Primarily to Ontario Rules

I. It is submitted that it is desirable for each firm carrying on business in Canada to be controlled in Canada so that it will be primarily concerned with the requirements of Canadian law and of the Canadian regulatory authorities. In this way any jurisdictional conflicts will be avoided.

It is also the view of the Exchange that the securities industry in this Province should be subject to one set of uniform rules which should be established by the appropriate Ontario authorities and made applicable to all Members. Such uniformity will not be achieved if special rules are needed for some firms because such firms continue to be controlled by non-residents into the indefinite future.

Neither will it be obtained if special rules are required because such firms are subject both to the Ontario rules and to foreign rules governing their operations which they are bound to observe because their principal interests lie in a foreign country. The demands of conflicting jurisdictions raise serious problems for any firm carrying on business in more than one jurisdiction either directly or through a subsidiary; but such conflicts are much more serious and much more likely to occur in the case of a firm carrying on a brokerage business which is subject to very detailed regulation by governmental and self-regulatory authorities.

Capital Needs of Canada May be Served By a Domestically Controlled Investment Industry

J. It is submitted that the capital needs of Canada can be served by an industry which meets the goals of the Ontario Government. It is sometimes suggested that a foreign interest in the Canadian securities industry is needed in order to secure foreign capital for this country. Very substantial amounts of capital have been raised in the United States by firms such as Morgan Stanley, Salomon Brothers, Drexel Harriman, Lehman Brothers and

Kuhn, Loeb, which have no active business in Canada. Nothing which is being proposed is likely to decrease their interest in underwriting and placing Canadian securities.

When it is desirable to raise money abroad, a securities firm or firms carrying on business there will undoubtedly be prepared, as they have in the past, to serve such need. The ability of a firm to raise money abroad depends on its distribution facilities and other capabilities in the foreign market and does not depend on whether it carries on business in Canada.

A review of Canadian financing will demonstrate that a very substantial portion of the underwriting in the United States for Canadian purposes has been done by American-based firms who do not have offices in Canada. For example, Salomon Brothers and Drexel Harriman have acted as the lead United States underwriters for all recent U. S. pay issues of the Province of Ontario aggregating over $500 million in the last five years. An examination of industrial issues will also show substantial participation by firms which do not carry on business here.

It is also relevant that the United States became a most mature financial community when its needs were served entirely by brokers controlled by American residents. It was not until the United States had attained a dominant position in the world financial markets that any foreign brokers were permitted to obtain membership in the major U. S. Exchanges. Accordingly, the domestic control of a securities industry does not constitute any threat to the ability of a country to meet its financial needs, both at home and abroad, and to develop a very strong financial community.

Industry May Be Competitive Without Foreign Participation

K. It has been suggested that the presence of U. S. owned firms will make the industry more competitive. It is submitted that the presence of 97 Canadian firms on the Toronto Exchange indicates that the level of concentration in this industry is already very low. The rapid changes in the membership of The Toronto Stock Exchange reflecting the emergence and disappearance of participants on a fairly regular basis evidences the competitive nature of the industry. It is also submitted that this number of participants in the Canadian industry should ensure that the public interest in competition can be preserved.

Exchange Recommendations will Achieve Desired Objectives

L. The Exchange submits that the recommendations of the Moore Committee, as amended by the Joint Industry Committee, do meet the problems outlined in the preceding paragraphs. It is the view of the Exchange that these recommendations, if adopted, will -

(a) Ensure "that ownership of investment companies remain substantially Canadian";

(b) Ensure that the existing participation by non-resident firms in the Canadian business does not increase and defeat the objective of Canadian ownership.

Results of Exchange Recommendations

M. These objectives will be attained under the recommendations by requiring non-resident controlled firms to resort primarily to Canadian capital for expansion purposes.

If the proposals are adopted -

(a) They should lead ultimately to the application of uniform rules and policies to all members of the industry; and

(b) The firms which do not now meet the desired objectives as to Canadian ownership may elect -

(i) either to continue their business in Canada largely by the use of the existing capital

employed in the Canadian operations: or

(ii) to sell their securities to Canadians over a relatively long period of time and under flexible conditions with the result that they may expand the capital used in their Canadian business.

Briefly, the recommendations provide that: -

(a) The Canadian operations of a non-resident securities firm should be conducted by a distinct Canadian entity;

(b) No more than 25% of the capital used by the entity may be provided by non-residents as a group;

(c) No more than 10% of such capital may be provided by any single non-resident and its associates, in the case of a firm having capital in excess of $1 million;

(d) All non-resident investors must be individuals approved by the regulatory authorities or securities firms dealing with the public;

(e) Any firm which does not presently comply with these standards may continue to conduct its business in Canada without altering the degree of non-resident ownership, provided that -

(i) it does not increase the amount of its capital by more than 10% of its earnings in any year;

(ii) it does not increase the amount of its capital beyond the maximum amount required to carry on its business in any one of the preceeding three years; and

(iii) such firm and its parent comply with all the capital rules and the rules governing Approved Investors, applicable to all Member firms of The Toronto Stock Exchange.

(f) Firms having a capital of less than $1 million should be able to increase that capital to $1 million without regard to the limitation in clauses (i) and (ii) of paragraph (e) above;

(g) Firms which choose to expand their capital more rapidly than permitted by paragraph (e) above would be allowed to do so provided that they used Canadian sources of capital. A firm wishing to expand its capital in this way would be able to do so if it now embarked on a program by which its Canadian ownership would be increased by a minimum of 15% in each succeeding three year period until the requisite Canadian ownership was obtained. Such a firm would have to comply with all other rules applicable to all Ontario firms;

(h) If the parent company of such a firm has chosen or subsequently chooses to obtain capital in a manner not permitted by the regulatory authorities or to have investors who are not approved, as required by the regulatory authorities, the Canadian firm must then embark on the program of acquiring Canadian ownership described in paragraph (g) above, so that by 1989 its capital sources will be subject to the rules applicable to all Ontario firms;

(i) Any non-resident could own 25% of the capital used by a Canadian firm provided the capital of such firm did not exceed $1 million.

(This recommendation was made because the Joint Committee recognized that it might be more difficult for smaller and regional firms to comply with the general requirements. Commencing in 1986 such firms would be expected to comply with the general rule.)

The adoption of these recommendations should ensure that the predominant part of all further capital required by the industry will be provided by Canadians. This will mean that, as the Canadian share of the capital used by the industry increases, the industry will also materially increase the extent of its Canadian ownership. When this plan of Canadianization is realized in 1989, all firms having any major share of the Canadian business will meet the general objectives as to Canadian ownership.

Furthermore, at that time all significant participants in the Canadian securities business will be governed by the same rules and will be responsible to and primarily concerned with the Canadian authorities.

Period for Attainment of Objectives

N. The period established for the attainment of these objectives is a relatively long one. The Committee thought it was appropriate that the firms which do not now meet the general objectives should have ample opportunity to obtain Canadian associates on a flexible basis which would permit the sale of their securities to be completed on favourable terms.

4. Should non-resident owners be permitted to provide additional financing by way of loans or by guaranteeing loans?

It is the submission of the Exchange that if non-resident owners may provide additional capital in this manner, it will be impossible to attain the desired objectives as to the ownership and control of the Canadian industry.

For example, if the greater part of the capital of a firm was obtained in this way, there can be little doubt that the lender would be able to exercise great influence over the firm. Indeed, a restriction on the increase of non-resident equity ownership is likely to have little more than a symbolic effect if the marjority of a firm's capital is provided by a non-resident in this way. The Canadian control of an existing registrant which is wholly-owned by Canadians could certainly be jeopardized if it sold 10% of its shares to a non-resident securities firm which immediately provided 90% of its capital by a substantial loan.

If this method of financing is permitted, despite the restrictions on equity participation, foreign capital participation may well take the form of extensive debt financing. The result could be that there will be little change in the extent of foreign participation in and influence on the industry in real terms.

It is the submission of the Exchange that the same rules should be applicable to debt financing as are applicable to equity financing.

Restrictions on Continued Registration of Non-Resident Controlled Firms

5. Should the registration of a registrant controlled by a non-resident be permitted to continue where (a) it obtains capital in a manner significantly different from that permitted to Ontario registrants generally; (b) there is any material change in the non-resident owners; or (c) it merges, amalgamates or experiences a corporate reorganization?

It is submitted that if a non-resident controlled firm is able to obtain capital in a way that is not permitted to Canadian controlled registrants, it will secure an advantage over such registrants. In addition, if a non-resident

controlled firm is permitted to obtain capital in such a way, the regulatory authorities will not be able to exercise the control and supervision over those providing capital to the industry which has so long been a feature of the regulatory process. It is submitted that a non-resident controlled firm should carry on its business under the same rules as any Canadian controlled firm.

Therefore, it is the position of the Exchange that any non-resident controlled firm wishing to raise additional capital should, save as permitted under the recommendations made by the Exchange, be required to raise that capital in exactly the same way as Canadian controlled registrants are permitted to raise capital.

It is recognized that there are some firms which have already raised capital by methods which are not permitted by the existing policies of the regulatory authorities. It is submitted that such registrants should be required to proceed as promptly as possible with a program to have their Canadian operations conducted by an entity which meets the ownership and control objectives of the Ontario Government in all respects. This program to enlarge Canadian ownership and to secure Canadian control should be carried out subject to the rules as to the expansion of the capital described in paragraph (e) of the recommendations of the Exchange as set forth under the heading "Non-resident Ownership".

If a non-resident firm subsequently elects to raise capital in a manner which is significantly different from that permitted to Ontario registrants generally, it is submitted that such a firm should also be required to proceed with the program outlined in the preceding paragraph.

It is submitted that if the recommendations of the Exchange are adopted, there may not need to be any real concern as to the effect of alterations in ownership or mergers, amalgamations or corporate re-organizations. If these recommendations are adopted, substantially all firms engaged in the securities industry will be Canadian controlled by 1989 and will have attained the desired objectives as to non-resident ownership. In other words, at that time, non-residents as a group would not have more than 25% of the capital of such a firm and no one resident would have more than 10% of such capital. In these circumstances it is unlikely that any such material change in ownership, merger, amalgamation or corporate re-organization would be made which was not consistent with the desired objectives. Of course, in such cases there would still need to be approval of those persons who manage or effectively control such a firm. The procedure for such approval is contained in the recommendations of the Exchange.

If the recommendations of the Exchange are not adopted, then in the submission of the Exchange, any such material change in ownership and any such merger, amalgamation or corporate re-organization should be regarded as a material change in the affairs of the firm in question and the firm should then be treated as an applicant for a new registration. It is submitted that if the non-residents presently engaged in the securities business are deemed to be entitled to an exemption from the generally applicable rules, that exemption should not be capable of being transferred to others.

It is also submitted that any material change in non-resident ownership must comply with the provisions of Section 6 a (3) of Ontario Regulation 101/67, as amended by Regulation 296/71. A transfer of equity shares to a non-resident will only be permitted if the transfer complies with the conditions set out in sub-clauses a and b of paragraph 2, subsection (2) of that Regulation.

Conclusion

6. The Government has concluded that the Canadian securities industry should be substantially owned and controlled by Canadians. It is the view of the Exchange that the adoption of the proposals developed by the self-regulatory bodies of the Canadian securities industry will best accomplish this objective.

REPORT OF THE JOINT INDUSTRY COMMITTEE ON THE MOORE REPORT

Following the publication of the Report of the Moore Committee in May, 1970 the Montreal/Canadian Stock Exchanges, the Investment Dealers Association of Canada, The Toronto Stock Exchange and Vancouver Stock Exchange (the Participating Institutions in the Moore Study) appointed a Joint Committee, with representatives from each of the Participating Institutions, to consider the Moore Report and make recommendations thereon. The recommendations of the Joint Committee are set forth hereunder in general terms with some of the reasons which influenced the Joint Committee in arriving at its decision. A more precise statement of the recommendations is attached as Appendix A.

RULES OF GENERAL APPLICATION

The Joint Committee is pleased to report that there has been unanimous agreement on the policy contained in its recommendations. A guiding principle in developing the policy was that to the extent possible, in the light of existing circumstances, the policy should be uniform in application to all the members of the Participating Institutions. Rules of general application have been adopted but certain exceptions are provided to meet the particular circumstances of certain classes of members.

Canadian Ownership of the Investment Business

Canadian governments, both Federal and Provincial, have enacted legislation to ensure Canadian control of key sectors of our economy. Restrictions affecting foreign ownership have been applied to newspapers, other publication companies, television and radio companies, communication companies, some natural resource companies and particularly to companies in the financial business such as trust companies, banks and insurance companies. The full extent of the test that Governments will apply to determine what aspects of our economy are deemed key sectors has not yet been enunciated.

The provision most commonly adopted to ensure Canadian control has been to limit overall non-resident ownership to 25% and individual non-resident ownership to 10%.

The Moore Report found that the securities business was a key sector of our economy. This finding is consistent with the policies adopted by various Governments in connection with other segments of the financial community. It pointed out that "we are aware of no country with an advanced or relatively advanced economy which has a securities industry in which foreign firms are preponderant".

Many countries have firm rules prohibiting foreign control of the securities industry concluding that such rules are essential in the national interest. The fact is that securities firms enter into foreign jurisdictions primarily for the purpose of attracting foreign capital to their home jurisdiction. There is evidence that rather than bringing capital into Canada non-resident firms have tended to take capital out of Canada. In the fiscal years ending April 1, 1964 to March 31, 1965, commissions earned by non-resident controlled firms operating in Canada on transactions in Canadian securities for Canadian residents aggregated $4.2 million as compared with commissions of $5.2 million on transactions in United States securities for Canadian residents. The proportion of Canadian transactions declined after 1965. For the fiscal years ended April 1, 1968 and March 31, 1969, commissions on transactions of Canadian securities for Canadian residents aggregated $10 million while commissions on transactions in United States securities for Canadian residents aggregated $17.2 million.

The question of national control of a securities industry is not primarily one of a prohibition against non-resident capital coming into the jurisdiction. The question is whether a jurisdiction should have a viable national securities industry amenable to and responsible to the needs of its community.

To maintain Canadian control of the securities industry, the Moore Report recommended that securities firms should not have a non-resident interest greater than the aforesaid percentages of 25 and 10%. The Joint Committee has adopted these same figures.

The Joint Committee differs with two recommendations included in the Moore Report. The first difference is with the Moore recommendation that those member firms presently controlled by non-residents should be exempt from the general rule limiting the degree of foreign ownership in a firm and should be permitted to retain their present form of ownership subject to losing their membership in the event of circumstances such as: change of control or the raising of money in a manner not permitted to securities firms in Canada. This type of exemption may be referred to as a "grandfather clause" and would treat these existing non-resident firms differently than all other non-resident firms because they had been accepted under previous rules. The Moore recommendation differs from most grandfather provisions in that in most grandfather cases the passage of time will in itself put all persons in the same position. There is no assurance under the Moore Report proposal that the passage of time would result in uniformity.

The second difference is with the recommendation of the majority of the Moore Committee against new investment by a non-resident firm in a Canadian firm based on the feeling that even a 10% investment might result in an undue influence over the Canadian firm. A minority report on this second point suggested that while 10% would be acceptable a larger percentage would not.

The Joint Committee has concluded that: these recommendations are not fully consistent with the rules applied by Governments; that they are on one hand too restrictive; that the exemption granted to existing non-resident controlled firms is not appropriate to ensuring the control of the Canadian securities industry by Canadians and that they do not meet the test of uniformity.

The Joint Committee recommends against the acceptance of the grandfather clause in the Moore Report. It recommends that the present non-resident firms should have an incentive to become Canadianized. These firms are dealt with hereunder as exceptions to the general rules on Canadian ownership.

The Joint Committee diverged from one other item in the Moore Report. The Moore Report favored the concept that a non-resident member should establish a corporate entity in Canada to operate its Canadian business but left this to the option of non-resident members. The Joint Committee recommends that this be obligatory. A distinct entity will facilitate the supervision of the Canadian operation of the member.

Investment by Non-Resident Securities Firms in Canadian Firms

While adopting fully the arguments that the securities industry is a key sector of the Canadian economy and as such should be controlled by Canadians, the Joint Committee favors the minority view in the Moore Report and believes that some investment by non-resident securities firms is permissible without losing the essential element of Canadian control of the industry. The Joint Committee also feels it is desirable that Canadian firms should be permitted to have some contacts in international markets through interlinking ownership arrangements with non-resident securities firms.

With these views in mind the policy adopted by the Joint Committee provides that non-resident securities firms may make up in whole or in part the 25% ownership permitted to be held by non-residents with any one firm's investment being limited to 10%. The investment by securities firms is further restricted in that if more than one non-resident firm makes up in whole or in part

the 25% non-resident interest then each would have to be unrelated to any other of the investing firms and have their main centres of business in different countries. The business such non-resident firms conduct in Canada would have to be conducted solely through the Canadian firm in which they have invested.

The General Rules recommended by the Joint Committee recognize that small firms and those firms not located in the principal financial centres may have more difficulty than large firms in establishing this form of relationship with non-resident securities firms. To assist such firms, the above percentages are varied to the extent that until March 31, 1986 a non-resident securities firm may have greater than a 10% interest, but such interest cannot exceed the lesser of $250,000 or 25% of the capital of the Canadian firm.

Non-resident investors, other than non-resident securities firms, would have to meet all the same tests that non-industry Canadian investors would have to meet under the Moore Report. Non-resident securities firms holding an interest in a member firm need not meet all such tests. They may, for example, have public shareholders provided the management and shareholding employees of the firm and anyone holding more than a 10% interest in the firm are approved after meeting appropriate tests.

This departure from the recommendation in the Moore Report will permit securities firms operating in Canada to have an association with securities firms in various countries, for example the United States, the United Kingdom, elsewhere in Europe and in Japan while still preserving Canadian control of the securities industry.

Public Ownership of Canadian Securities Firms

The Joint Committee has adopted the reasoning and conclusions in the Moore Report that open public ownership of Canadian controlled securities firms is not appropriate in Canada at this time. In brief, the Moore Report recommended that only 40% of the capital of such firms may be supplied by non-industry investors and that no more than 25% of the equity of a firm may be owned by non-industry investors with a maximum of 10% to any single non-industry investor. All investors in these firms must be approved by the regulating bodies subject to specific exceptions, such as loans from chartered banks, as set out in the Report. It is an advantage for the self-regulatory bodies to know the identity of the persons who control securities firms and to be able to deal with such persons directly and quickly.

It is felt that the safeguards built into the recommendations in the Moore Report will preserve the ability of the self-regulatory bodies in Canada to maintain high standards in the industry. This ability has led to progressively higher standards of conduct and qualifications over the years.

The Joint Committee recognizes that there are arguments on both sides of the question of public ownership. Public ownership can have certain advantages but it also has certain drawbacks. To date, the securities industry has financed itself in the same manner as do the legal and medical professions in that capital is raised within the industry. Older members of the industry pass control to younger members at book value or at a discount therefrom. It is not usual to place any value on goodwill, goodwill being deemed to be a personal attribute of the individuals in the firms rather than of the firm itself.

This treatment of the industry as a quasi-profession is consistent with the desire of both the self-regulatory and government regulatory bodies to increase professionalism in the industry.

Public distribution of the shares of securities firms raises another question of principle. At present, even when acting as underwriters, dealers are in the position of intermediaries. They are trading in the securities of companies in which they have no personal interest. More complicated questions of behaviour arise when they are trading in the securities of their own firms. Instead of acting in the normal role of intermediary they are directly involved and have a continuing personal interest in the pricing of the securities.

This pricing of securities is particularly complicated in this type of service industry where so much of the value of the securities depends upon the ability of the persons within the firm who are rendering the service. As mentioned above, goodwill is largely a personal attribute of the individuals in the firm rather than of the firm itself. This is clearly evident with all but very large securities firms.

While the securities industry has developed along professional lines it, unlike most other professions, requires considerable amounts of capital. The source of capital comes mainly from retained earnings. The Moore Report in its review concluded that the need for capital was not as serious a problem as some had argued, although there is a major problem in the transfer of ownership from older to younger members of a firm. The purchase price must be paid out of after-tax earnings and high income tax rates make this difficult.

In light of the pros and cons of the argument on public ownership the Moore Committee recommended only a partial opening of the door.

Under this approach, firms can increase their capital base: but the regulatory process is still maintained. This compromise has been accepted by the Joint Committee, partly on the ground that the new and more lenient rules will enable the participating bodies to gain some experience on the effect of ownership by non-industry investors.

While the recommendations in the Moore Report have been accepted it is generally recognized that the matter of public ownership will be one of continuing debate. The experience here and that in the U.S. may well lead to the development of rules which will permit wider public ownership.

The decision to restrict the source of outside capital will place Canadian securities firms at a disadvantage to U.S. controlled member firms. The U.S. firms would have more freedom to expand by bringing in public capital unless some restriction was placed thereon. There is a legitimate concern that the more lenient rules in the U.S. will give American firms an unfair advantage over Canadian firms.

EXCEPTIONS TO GENERAL RULES

As mentioned above, certain exceptions have been included in the policy to meet existing conditions. These exceptions apply to those member firms which are presently controlled by non-residents. The basic approach to them has been that their future growth should be accomplished by taking in Canadian capital.

Existing Members – Non-Resident Controlled

The Moore Report recommended that those member firms who are presently non-resident controlled should be permitted to carry on their memberships provided they meet the same capital and approved investor provisions applicable to Canadian controlled firms. They were to be given the benefit of a grandfather provision. Objection was made to this recommendation as under it the present non-resident firms would have a special benefit not available to any other non-resident firm and an ability to establish international associations not available to Canadian controlled firms under the General Rules. It was also argued that to be fully consistent with the basic principle that the Canadian securities industry should be Canadian controlled, no such grandfather provision should apply to those non-resident firms already here. Part of the argument was that the size and international connections of these firms would make it possible for them to dominate the Canadian industry over a period of time. As mentioned below, since the Report, some large non-resident firms have indicated that they will be obtaining capital in a manner which is not permissible for Canadian firms.

The conclusion was reached that while there should not be a forced roll-back of present ownership by compelling sale of control to Canadians, most future growth should come from

Canadian sources. Consequently each present non-resident controlled firm will have to operate in Canada through a Canadian company and will be placed under a capital freeze with the right to expand its operation if it embarks upon a program of Canadianization.

The recommendation is that the maximum capital that the Canadian company controlled by a non-resident securities firm can employ in its business be that required by the capital formulae of the Exchanges and the Investment Dealers Association to maintain the business transacted by it (or the Canadian branches of its non-resident predecessor firm) during a recent fiscal year ending not later than March 31, 1971 plus 10% of its net earnings in each year.

The Joint Committee concluded that without some form of freeze on capital, the non-resident controlled firm could increase its capital base and ability to expand by ploughing back all its Canadian earnings. They would have the ability to do so since they would have an additional source of earnings outside Canada in the parent company, usually the only shareholder. This same ability would not be available to Canadian firms who must pay out a substantial part of their total earnings to their shareholders in order to give their shareholders a reasonable return on capital.

The Joint Committee points out that growth through retained earnings is a common characteristic of U.S. controlled subsidiaries in Canada. The April-May 1971 Monthly Review of The Bank of Nova Scotia contained the following statement:

> . . . but direct investment can also proceed without any cross-border movement of capital at all, as occurs when foreign corporations increase their control over assets through an investment in kind or a reinvestment of subsidiary earnings. As may be seen in the accompanying table, funds from the United States actually supplied a relatively small proportion of the total financing needs of U.S. controlled companies in Canada between 1963 and 1968. Over 60% of the funds used for the expansion of these firms in the indicated years was, indeed, "internally generated" by the affiliates themselves in the form of retained earnings and depreciation and depletion allowances. Of the "external" supplies of financing coming other than from the United States the most important have been through direct borrowings in Canada, either by security issues, by bank loans, or by short-term trade credits.

In 1968, retained earnings of U.S. subsidiaries were \$529 million and depreciation \$864 million while funds from the U.S. were only \$127 million. Funds obtained from Canadian banks and other Canadian sources were \$539 million.

These figures indicate that a freeze on capital importation, without limiting the amount of retained earnings which can be used to expand the business, will have a limited effect on the ability of non-resident firms to expand.

A firm which is a subsidiary of a non-resident parent need not pay out any of its earnings since appropriate pay-outs can be made by the parent from other sources of income. There is very little pressure on a non-resident subsidiary to issue more equity stock.

This result is particularly significant in the securities business. Securities firms, because of the nature of their business, have few capital assets upon which depreciation can be claimed. As a consequence, internally generated funds come primarily from retained earnings. In addition, securities firms are under pressure to pay out their earnings. It is necessary for such firms to roll over their ownership from the older shareholders to the younger in a relatively few years. To facilitate the purchase by the younger people, the firms must pay out a substantial part of their earnings. As a consequence, the possibility for growth from retained earnings is less with Canadian securities firms than other businesses.

The capital freeze will limit the ability of the non-resident firm to grow. To offset this, and as an incentive for these firms to Canadianize, it is recommended that if the non-resident controlled Canadian firm wishes to enlarge its operation in Canada it can elect to embark upon a program of Canadianization. If it so elects, it must increase its Canadian ownership under the following formula:

15% by 1974
30% by 1977
45% by 1980
60% by 1983
75% by 1986

By 1986, it will have reached the 25% non-resident ownership provision permitted to all members. The non-resident parent must then take an additional step of reducing its ownership to 10% by 1989 either by selling a further 15% to Canadians or to other non-residents as provided above.

The Canadian company which embarks upon the Canadianization programme will be permitted to increase its capital by retaining in its Canadian securities operation additional earnings, of 1.2% for each 1% of ownership transferred to Canadians over and above its basic 10%.

There will be no forced programme of Canadianization on those firms which either directly or through their foreign parents raise capital in the same manner as is permitted to Canadian controlled firms and which elect to remain under the capital freeze. However, it is hoped that all non-resident firms would elect to be Canadianized by 1986 under the above formula.

Non-Complying Non-Resident Controlled Firms

Because of altered circumstances since the issuance of the Moore Report, a different approach on public ownership from that provided under the General Rules is being recommended with respect to non-resident controlled firms which, although presently members of one or more of the Participating Institutions, fail to comply with the by-laws of such institutions.

As stated above, the Moore Report recommended that the present non-resident controlled firms should be permitted to carry on in Canada only if they meet the same capital and approved investor provisions applicable to Canadian firms. Member firms of U.S. exchanges are now allowed to obtain capital from non-industry investors and from non-approved investors on terms not permitted Canadian firms under existing by-laws or under the General Rules. Some of the U.S. controlled firms, which are members of the Participating Institutions, are taking advantage of these changes in the United States rules to raise additional capital. As a consequence, these firms do not comply with the existing by-laws of the Participating Institutions nor with the recommendations in the Moore Report.

The Joint Committee recognizes that the Participating Institutions have been faced with a dilemma not of their making. Either they could, as suggested in the Moore Report, expel these non-complying firms from membership, or they could adopt some compromise which would permit them to operate in Canada. In considering the dilemma, the Joint Committee was influenced by the fact that these firms had a number of employees and commitments in Canada.

It was decided to take the compromise approach recognizing that, as with most compromises, the result was not entirely consistent with the basic principles of the General Rules.

The compromise is that these firms would be given a period of 18 years to comply with the General Rules. However, unlike the non-resident firms which do comply with the provisions in the General Rules for obtaining capital, the non-complying firms would not be able to elect to comply with the General Rules. They would be required to reduce their ownership to the 10% permitted for participation by a non-resident securities firm in a Canadian firm by 1989, in the stages required for a non-resident firm which elects to be Canadianized, with the same right to retain more of their earnings in Canada as the percentage of Canadian ownership increases. Thus, after the transitional period, these firms would meet both the required degree of Canadian control and also would have the same relationship with a non-resident securities firm as is permitted by the General Rules.

UNIFORMITY

The policy recommended will, by 1989, bring all member firms under the same General Rules except for the exemption granted to those present non-resident members which do not elect to become Canadianized but decide to accept the freeze on capital and comply with all the other provisions in the General Rules. It is recognized that the period allowed to reach uniformity is lengthy but it was felt that it was better to adopt a longer rather than a shorter period in order that there be a large degree of flexibility for those firms which will be obtaining capital in Canada.

APPENDIX "A"

DETAILED RECOMMENDATIONS OF THE JOINT INDUSTRY COMMITTEE ON THE MOORE REPORT

Names of Affiliates

1. By March 31, 1972, all members, their affiliates operating in Canada and any security firm parents must have the same or substantially similar names. In the meantime, where any such names are dissimilar, the nature of the relationship must be disclosed in all communications to the public, including letterheads, advertisements, confirmations and prospectuses but excluding syndicate advertisements.

General Rule for Canadian Firms and for Non-resident Firms

2(1). Except as provided in paragraph 4 below with respect to the approximately 14 existing non-resident controlled Exchange or IDA members, the maximum non-resident ownership of any Exchange or IDA member is 25% for all non-residents and 10% for any one non-resident (including associates). However until March 31, 1986 any one non-resident may exceed 10% up to the lesser of $250,000 or 25%. The maximum percentages for ownership apply to voting power, participation in profits and all forms of capital.

2(2). Such non-resident investors must be either

(a) Industry or Approved Investors in accordance with the Moore Report except that their residence and business need not be in Canada ("eligible non-resident investors"), or

(b) non-resident securities firms dealing with the public in another country but not transacting any security business here or having any interest in any other Canadian securities firm, provided that:

(i) except as provided in subclause (ii) below, all the investors and their investments in each such non-resident securities firm must be approved by the Exchanges and IDA, but such approval need not be conditional on them meeting all the requirements of eligible non-resident investors;

(ii) some of the securities of such a non-resident securities firm may be held and traded by the public and, in that case, subclause (i) applies only to non-public securityholders (including management) and to any person or group having effective control or more than 10% ownership; and

(iii) two or more non-resident securities firms may invest in the same member only if they are unrelated and the main centres of their businesses are in different countries.

Non-resident Firms must have Canadian Companies

3. Each member which is presently non-resident controlled and is not a Canadian company must establish a Canadian company that takes over its Canadian operations and is eligible for membership by March 31, 1972.

Exemption for Existing Non-resident Firms

4(a). Each non-resident controlled firm that is now a member (or its successor under clause 3) need not comply with clause 2(1) if and so long as:

(i) only eligible non-resident investors are investors in any non-resident securities firm which has any investment in the member;

provided that in this case

(ii) the maximum capital which it can employ in its business is that required by the Exchanges' and IDA capital formulae to sustain the business transacted by it (or the Canadian branches of its non-resident predecessor firm) during a recent fiscal year ending not later than March 31, 1971, plus 10% of the firm's net earnings in each future year.

Transition for Existing Non-resident Firms

4(b). As an alternative for firms that do not comply with 4(a)(i) or wish to employ in their business more capital than permitted by 4(a)(ii), each non-resident controlled firm that is now a member (or its successor under clause 3) need not comply with clause 2(1) until March 1, 1989 provided that both:

(i) its Canadian ownership is at least the percentage indicated below on or after March 1 in each of the following years:

1974	15%
1977	30%
1980	45%
1983	60%
1986	75%

and

(ii) the maximum capital which it can employ in its business is that prescribed by clause 4(a)(ii) plus a percentage of the firm's net earnings in each future year equal to 1.2% for each 1% Canadian ownership in such year.

THE JOINT INDUSTRY COMMITTEE STUDYING THE MOORE REPORT

Press Release

The Joint Industry Committee studying the Moore Report has today issued its recommendation concerning the implementation of and modifications to the Moore Report.

The Committee to Study the Requirements and Sources of Capital and Implications of Non-Resident Capital for the Canadian Securities Industry headed by Mr. Trevor Moore made a number of recommendations in its Report. Following the issuance of the Moore Report in May, 1970, the Montreal/Canadian Stock Exchanges, the Investment Dealers Association of Canada, The Toronto Stock Exchange, and the Vancouver Stock Exchange (the Participating Institutions) formed a Joint Committee with representatives from each of the Participating Institutions. The Joint Committee has had numerous meetings directed to reaching a consensus on the implementation of the Report and appropriate modifications thereto:

The Joint Committee has reported its conclusions to the Stock Exchange Governors and the National Executive of the Investment Dealers Association of Canada. They have directed that the recommendation of the Joint Committee be distributed to all members with requests for comments. These comments will be taken into account by the Governors and National Executive of the Participating Institutions, prior to the finalization of a policy.

The uniform policy developed and unanimously agreed upon by the Joint Committee recommends that the fundamental conclusions of the Moore Report be accepted with some variations therefrom in the area of non-resident ownership. The variations recognize the particular needs of the various areas of Canada represented by the Participating Institutions and the fact that certain events have taken place since the Moore Report was issued.

The principal recommendations of the Moore Report were[1]

(a) that the securities industry as a key sector of the Canadian economy should be controlled by Canadians;

(b) that there be more liberal financing regulations for Canadian securities firms to enable them to raise outside capital from approved investors. In particular, the report recommends that 40% of the capital of the securities firm could be obtained from the public, provided all investors are approved by the self-regulatory bodies and that no one outside investor has more than a 10% ownership interest.

The report spelled out in detail the means whereby the Participating Institutions could maintain their ability to self-regulate the industry, an ability which has led to progressively higher standards of conduct and qualifications;

(c) that securities firms in Canada should not have their shares traded publicly.

The points on which the Joint Committee departs from the recommendations of the Moore Report are –

(1) the Moore Report recommended that there could be a 25% non-resident investment in a Canadian securities firm, with not more than 10% with any one non-resident investor, but it recommended that a non-resident securities firm should not be permitted to acquire an interest in a Canadian firm. There was a minority report on this point. The majority felt that a 10% investment by a non-resident securities firm might subject the Canadian firm to an undue degree of foreign influence. The Joint Committee has adopted the minority report

[1] For further details of the Moore Report see the attached Press Release issued by the Moore Committee, June 15th, 1970.

provided that if more than one non-resident securities firm is a shareholder then they must be unrelated, have their main centres of business in different countries and that any non-resident securities firm which has an interest in the Canadian firm must do all its Canadian business through that Canadian firm;

(2) the Joint Committee has recognized that the obtaining of a non-resident investment will be more difficult for small firms and particularly those firms who operate outside the main financial centres. The Joint Committee recommends that, until March 31, 1986, a non-resident may have an investment in a Canadian firm exceeding the 10% limit but only up to the lesser of $250,000 or 25%;

(3) the Joint Committee has adopted the finding in the Moore Report that persons investing in a member should be subject to approval by the self-regulatory bodies subject to a minor exception for the shareholders of a non-resident firm which has an interest in a Canadian firm. In that case, all the shareholders of the non-resident firm who are industry investors, i.e. those employed by or who manage the firm, and those having effective control or more than 10% ownership would have to be approved;

(4) the Moore Report recommended a "grandfather" exemption be granted to non-resident controlled firms which are presently members. The Joint Committee recommends that this should be changed and that the maximum capital that such a firm can employ in its Canadian business be that required by the Exchanges' and I.D.A.'s capital formulae to sustain the business transacted by it (or the Canadian branches of its non-resident predecessor firm) during a recent fiscal year ending not later than March 31, 1971 plus 10% of the firm's net earnings in each year. A provision is included which would permit these firms to retain in their business a greater percentage of their earnings if a firm elects to Canadianize by acquiring Canadian shareholders under a proposed formula. The non-resident firm would be entitled to retain 1.2% of its earnings for each 1% of equity acquired by Canadians provided it becomes Canadianized under the following timetable:

15% by 1974
30% by 1977
45% by 1980
60% by 1983
75% by 1986

In addition, since the firm would have to comply with the general provisions in the Moore Report that no one non-resident owner could own more than 10% of a Canadian securities firm such firm would have to divest itself of another 15% either to non-residents or Canadians within a further three years.

The Joint Committee is of the view that the above provision will achieve the national goal of Canadian control of the Canadian securities industry without undue hardship on the present non-resident controlled members;

(5) the Moore Report indicated that any non-resident controlled firm which raised capital in a manner not allowed to Canadian firms, for example by making a public distribution of its shares, or where control

of such firm changed should be subject to having its membership withdrawn. Events of this nature have occurred since the date of the Report. The Joint Committee has faced this problem by recommending that any such firm must immediately embark upon a program of divesting its interest in the Canadian company under the timetable provided for Canadianization in paragraph 4 above;

(6) in order to ensure the effectiveness of these recommendations and to provide for effective supervision, the Joint Committee recommends that it be obligatory for each member which is presently non-resident controlled and is not a Canadian company to establish a Canadian company that takes over its Canadian operation by March 31, 1972. The Moore Report, while favouring this result, left the attainment of it permissive rather than obligatory.

The Joint Committee adopted the conclusion of the Moore Report that a securities industry controlled by Canadians would be more responsive to the needs of the Canadian economy. It recognizes that it is the responsibility of the Canadian industry to serve the needs of the investing public, corporations and Governments in all parts of Canada.

The governing bodies of the Canadian/Montreal Stock Exchange, the Investment Dealers Association, The Toronto Stock Exchange and the Vancouver Stock Exchange have requested their members to submit their comments in writing to the Joint Committee prior to August 11, 1971. The Joint Committee will process the comments and report the results back to the governing bodies.

COMMITTEE TO STUDY THE REQUIREMENTS AND SOURCES OF CAPITAL FOR THE CANADIAN SECURITIES INDUSTRY AND THE IMPLICATION OF NON-RESIDENT CAPITAL

Chairman: TREVOR F. MOORE

Members: NORMAN J. ALEXANDER
G.R.P. BONGARD
W.T. BROWN
PETER KILBURN
J.R. LEMESURIER
F.R. WHITTALL

Secretary: ROY W. REID

FOR RELEASE NOT BEFORE
4:30 p.m. E.D.S.T.
June 15, 1970

Foreign companies should no longer be allowed to acquire ownership interest in Canadian securities firms, says the Report of the Moore Committee on the Canadian securities industry. The recommendation does not affect the present status of foreign based firms currently operating in Canada but does prohibit them from purchasing an interest or taking over Canadian investment firms in the future.

The 150-page Report released today was prepared by a seven-member Committee on behalf of the Investment Dealers' Association of Canada and four stock exchanges - - the Canadian, Montreal, Toronto and Vancouver -- in all representing 182 separate securities firms. It was chaired by Trevor F. Moore, a former member of the investment industry and recently retired Senior Vice-President of Imperial Oil Limited.

Studies into the costs and benefits resulting from foreign control in the investment industry led to the conclusion that no further investments by foreign firms in Canadian member firms be allowed, especially as a comparatively small investment by a United States firm in a small Canadian firm have a disproportionate impact on the latter. The net worth in 1969 of 12 United States based securities firms doing business in Canada was $595 million compared with a total net worth of $183 million for the 182 Canadian member firms of the bodies sponsoring the Study.

In looking at the securities industry as a "key sector" of the Canadian economy, the Report found that no other country of which it is aware has a securities industry in which foreign firms have a preponderant interest.

"Canada has recognized that the national interest requires the retention of Canadian control over banks, loan companies, trust companies, life insurance companies and finance companies; the same conclusion should apply to securities firms."

It is recommeded that no further investments of foreign firms, whether already established in Canada or not, be permitted in the Canadian member firms of the bodies sponsoring the Study, and that no foreign firm should be granted registration in the Canadian securities industry if it or its parent is financed in amanner significantly different from that permissible for Canadian firms.

The Report proposes that there be more liberal financing regulations for Canadian securities firms to enable them to raise outside capital from approved investors instead of relying almost exclusively on internal sources. But, in doing so, it rejects the idea of a securities firm "going public" as has happened in the United States following recent regulatory changes on some stock exchanges in that country. It stresses the belief that the majority of voting shares should at all times be owned by officers and employees actively engaged in the operations of the business.

The acquisition of a long-established Canadian investment dealer by the wholly-owned Canadian subsidiary of a United States securities firm led to the creation of the Committee in July, 1969, the Report says, but its responsibilities were not restricted to the question of non-resident capital. Its terms of reference embraced an examination of the reqirements and sources of capital for the Canadian securities industry.

In recommending a liberalization of financing, the Report notes that historically Canadian securities firms have adequately met their need for capital from those sources available to them, consisting mainly of funds from officers and employees, and from retained earnings. Because it believes it reasonable to assume that for the industry as a whole these sources of capital will continue to meet demands in the near future, the Report concludes that additional sources of capital will probably not be required by the industry as a whole.

"However, it is recognized that there are a number of firms of various sizes that will require additional sources of capital to achieve their desired growth objectives, particularly if they wish to concentrate on capital-intensive activities." Alternative sources of capital also would help alleviate the turn-over problem -- the sale of an investment firm by senior employees and officers to juniors.

The Committee in concluding that the present restrictions on sources of capital should be relaxed emphasizes that such liberalization should be to the extent consistent with the public interest. Limitations suggested for outside capital would maintain adequate competition in the business and preserve the good faith relationships between securities firms and their clients. It was felt that this was essential for the preservation of a viable and healthy Canadian securities industry, both for the operation of the national economy and for the protection of the investor.

Under the Report's proposals, outside capital from approved investors should be permitted to a maximum of 40 per cent of a firm's invested capital. This would allow "substantial flexibility" to securities firms, permitting an increase in capital of up to 66 2/3 per cent. For example, a firm with $3,000,000 capital could raise an additional $2,000,000 from outside investors, bringing its total capital to $5,000,000. Equity financing would be subject to other requirements, including a provision that no more than 25 per cent of the voting securities of the firm be held by outside investors which have been approved, as well as a provision limiting each individual's investment to 10 per cent of the total equity. In addition, the aggregate of outside investors in the equity of each firm would be restricted in number to 25.

By "approved investors" the report means those requiring approval of the regulatory bodies of the Canadian securities industry as is currently given to officers and employees of brokers and investment dealers. For the purpose of equity financing, purchasers must be individuals. For debt, banks and other lending institutions

are considered approved investors for normal financing purposes. If the loan is made by an individual it is subject to approval if it carries any restrictive covenants.

Though foreign firms would be prohibited from taking equity interest in Canadian securities firms, approved non-resident individuals could supply both debt and equity capital subject to the same limitations as those for Canadians.

Taking into account the ownership of voting shares by employees of the firm resident in other countries and the possibility of approved non-resident individuals also owning shares, the report recommends that over 50 per cent of the firm's voting shares must at all times be owned by resident industry investors – officers and employees living in Canada.

The Report rejects the concept of securities firms "going public" and having their shares traded publicly, as is now possible on the New York and Mid-West Stock Exchanges, because of the basic premises which are considered essential to the recommendations:

1. that officers and employees should at all times own the majority of voting shares; and,
2. public trading markets in voting shares should be avoided.

The anti-competitive consequences of broad public distribution would be more serious in the much smaller Canadian securities industry.

The regulations proposed for Canada therefore lie between the existing Canadian rules and those of the New York Stock Exchange.

With respect to non-member firms, the Report of the Moore Committee says it trusts that self-regulatory organizations will propose to securities commissions and other appropriate governmental agencies a pattern of restrictions on sources of capital no more liberal than those proposed in the Report.

The Moore Committee understands that the Report will receive consideration by the sponsoring bodies and that discussions will take place between them and with the appropriate government bodies who have already received the Report. The Committee also understands that in order that the Report may receive adequate consideration the sponsoring bodies will not consider new applications for membership from foreign-based brokers and investment bankers nor any new applications for approval of purchases by foreign interests of Canadian securities firms now holding membership in any of these industry organizations at least until October 1, 1970 or for such longer period as may be necessary.

Committee members were Norman J. Alexander, Managing Partner, Richardson Securities of Canada, Winnipeg; Gordon R.P. Bongard, Executive Vice-President, Bongard, Leslie and Co. Ltd., Toronto; W. Thomas Brown, President, Odlum Brown & T.B. Read Ltd., Vancouver, Peter Kilburn, Vice-Chairman, Greenshields Incorporated, Montreal; J. Ross LeMesurier, Vice-President, Wood Gundy Securities Limited, Toronto; Fred R. Whittall, President, C.J. Hodgson and Co. Inc., Montreal. Secretary to the Committee was Roy W. Reid, Economist, A.E. Ames and Co. Limited, Toronto.

APPENDIX "B"

RECOMMENDATIONS OF THE JOINT INDUSTRY COMMITTEE ON THE MOORE REPORT AS AMENDED AND ADOPTED

Names of Affiliates

1. By March 31, 1972, all members, their affiliates operating in Canada and any security firm parents must have the same or substantially similar names. In the meantime, where any such names are dissimilar, the nature of the relationship must be disclosed in all communications to the public, including letterheads, advertisements, confirmations and prospectuses but excluding syndicate advertisements.

General Rule for Canadian Firms and for Non-resident Firms

2(1). Except as provided in paragraph 4 below with respect to the approximately 14 existing non-resident controlled Exchange or IDA members, the maximum non-resident ownership of any Exchange or IDA member is 25% for all non-residents and 10% for any one non-resident (including associates). However until March 31, 1986 any one non-resident may exceed 10% up to the lesser of $250,000 or 25%. The maximum percentages for ownership apply to voting power, participation in profits and all forms of capital.

2(2). Such non-resident investors must be either

(a) Industry or Approved Investors in accordance with the Moore Report except that their residence and business need not be in Canada ("eligible non-resident investors"), or

(b) non-resident securities firms dealing with the public in another country but not transacting any security business here or having any interest in any other Canadian securities firm, provided that:

(i) except as provided in sub-clause (ii) below, all the investors and their investments in each such non-resident securities firm must be approved by the Exchanges and IDA, but such approval need not be conditional on them meeting all the requirements of eligible non-resident investors;

(ii) some of the securities of such a non-resident securities firm may be held and traded by the public and, in that case, sub-clause (i) applies only to non-public securityholders (including management) and to any person or group having effective control or more than 10% ownership; and

(iii) two or more non-resident securities firms may invest in the same member only if they are unrelated.

Non-resident Firms must have Canadian Companies

3. Each member which is presently non-resident controlled and is not a Canadian company must establish a Canadian company that takes over its Canadian operations and is eligible for membership by March 31, 1972.

Exemption for Existing Non-resident Firms

4(a). Each non-resident controlled firm that is now a member (or its successor under clause 3) need not comply with clause 2(1) if and so long as:

(i) only eligible non-resident investors are investors in any non-resident securities firm which has any investment in the member;

provided that in this case

(ii) the maximum capital which it can employ in its business is the greater of $1,000,000 or that required by the Exchanges' and IDA capital formulae to sustain the business transacted by it (or the Canadian branches of its non-resident predecessor firm) during a recent fiscal year ending not later than March 31, 1971, plus 10% of the firm's net earnings in each future year.

Transition for Existing Non-resident Firms

4(b). As an alternative either for firms that do not comply with 4(a)(i) or for firms that do so comply but wish to employ in their business more capital than permitted by 4 (a)(ii), each non-resident controlled firm that is now a member (or its successor under clause 3) need not comply with clause 2(1) until March 1, 1989 provided that both:

(i) its Canadian ownership is at least the percentage indicated below on and after March 1 in each of the following years:

1974	15%
1977	30%
1980	45%
1983	60%
1986	75%

and

(ii) the maximum capital which it can employ in its business is that prescribed by clause 4(a)(ii) plus a percentage of the firm's net earnings in each future year equal to 1.2% for each 1% Canadian ownership in such year.

<u>NOTE:</u> *The marginal lines indicate changes from the policy statement of June 16, 1971.*

APPENDIX "C"

THE TORONTO STOCK EXCHANGE

234 BAY STREET

TORONTO, CANADA

NOTICE TO MEMBERS
NO. 761

JANUARY 25, 1971

BALLOT ON MAY, MIKKILA AND CO. LIMITED

Notice to Members No. 754 announced receipt of an application for Membership from May, Mikkila and Co. Limited. The reference to the Moore Report and the proposed participation by way of Senior Subordinated Notes by three individuals who will not be active in the firm have raised some questions amongst Members. This notice will attempt to clarify Exchange policy on the matter of outsider capital contributions.

Among other things, the Moore Report recommends

1. that a securities firm which has outstanding subordinated debt contributed by outside investors should be required to maintain not less than three dollars of equity capital (including junior subordinated debt) for each dollar of such subordinated debt;

2. that the maximum percentage of total capital contributed by outside investors including both equity and subordinated loans is limited to 40%;

3. that only individuals be permitted to be "approved investors", who must be the beneficial owner of such securities, and understand that their investment will not carry any influence over the operations of the firm;

4. that each securities firm in which approved investors have an investment should make arrangments whereby each approved investor is obligated to dispose of the instruments representing his investment in the firm upon withdrawal of his approval as an approved investor or upon his bankruptcy, insanity or death.

This Exchange together with the other participants in the Moore Study has adopted this recommendation as a part of Exchange policy.

The present application meets the above tests.

The Senior Subordinated Notes of May, Mikkila and Co. Limited are non-participating, bear a fixed interest rate and will be held by the following:

John P. Sheehan	– Director Dominion Magnesium Ltd.
	– Secretary-Treasurer Chromium Mining & Smelting Corp. Ltd.
	– Assistant Secretary-Treasurer Timmins Investments Ltd.
Norman F. Jefferson	– Regional Comptroller Acklands Limited
Jack Plumpton	– Comptroller Dominion Foundries and Steel Ltd.
	– Vice-President and Director National Steel Corp. Ltd.

The required subordinated agreements have been filed with the Exchange Auditor and will be released only with his approval.

The Exchange has on file declarations from the above that the monies are their personal funds and that they will receive no benefits from May, Mikkila and Co. Limited other than the benefits accruing under the terms of the Notes. The Notes will form just over 20% of the total capital of the firm, using calculations as recommended in the Moore Report.

The acceptance of outside investors by means of subordinated loans does not offend any existing by-law of the Exchange, such investment having been permitted in the past under Exchange policy as developed by the Board of Governors within the framework of the by-laws. It has not been the practice of the Exchange to disclose these types of investment in the past which have formed a very minor portion of the total borrowings of Members and confined to a very minimal number of exceptional circumstances. The disclosure of the names of the three outsiders in the present application is given because this is the first application of the Moore recommendations and is done without prejudice to future applications pending development of a new policy of procedure and disclosure.

The Board has now approved the application of May, Mikkila and Co. Limited as a Member with officers, shareholders and directors as follows:

C.V. May — Chairman of the Board, Shareholder and Director
W.G. Mikkila — President, Shareholder and Director
C.E. Pyne — Shareholder and Director
P.J. Stefanic — Secretary only
and with Messrs. Sheehan, Jefferson and Plumpton as holders of Senior Subordinated Notes.

Mr. Mikkila will hold 74.9% of the voting shares and Mr. May 25%. The Member-Seatholder will be Mr. May.

As required under sections 3.18 and 3.14 of the General By-law the application is now referred to Members for ballot. The ballot has been called for Tuesday, February 9th, 1971.

Ballots may be cast either at the Exchange between 10:00 o'clock in the morning and 3:30 o'clock in the afternoon or by mail or delivery if received by the Exchange at any time prior to 3:30 o'clock on February 9th.

The following forms are enclosed for those Members wishing to mail their ballots.

1. Ballot. (If your firm is the owner of more than one seat the appropriate number of ballots and corresponding envelopes are enclosed.)

2. Letter to be returned to the Secretary with the ballot(s).

3. Form of proxy.

4. Envelope(s) for ballot(s) and envelope to be returned to the Secretary.

INSTRUCTIONS

1. Mark ballot(s) — to be marked by Member-Seatholder or proxy (see 5 below).

2. Seal the ballot(s) in the envelope(s) marked "FOR BALLOT ONLY." If your firm has more than one vote seal each ballot in separate envelopes.

3. Sign the return letter, otherwise ballot cannot be counted.

4. Enclose both the return letter and the envelope(s) containing the ballot(s) in the envelope addressed to the Secretary.

5. If a proxy is used instructions for execution are given on the form of proxy enclosed. The ballot may then be cast by the proxy at the Exchange or by mail as in 1, 2, 3 & 4 above. If the ballot is cast in person the proxy must produce the form appointing him. If the ballot is cast by mail, the proxy must be returned with the return letter as in 4 above.

NOTE: *THOSE MEMBERS WISHING TO CAST THEIR BALLOT(S) PERSONALLY AT THE EXCHANGE MUST BRING THEIR BALLOT(S) AND PROXY, IF USED, WITH THEM.*

BY ORDER OF THE BOARD OF GOVERNORS

(Miss) A. CURRIE,
Secretary

APPENDIX "D"

MARGIN REQUIREMENTS OF THE INVESTMENT DEALERS ASSOCIATION OF CANADA FOR MONEY MARKET OPERATIONS

REVISION OF REGULATION 103

103. For the purpose of this Part, and By-law 17.9 the following margin requirements are hereby prescribed:

BONDS, DEBENTURES, TREASURY BILLS AND NOTES

I. Bonds, debentures, treasury bills, and other securities of or guaranteed by the Government of Canada, of the United Kingdon and of the United States, and Canadian chartered bank acceptances maturing (or called for redemption):

within 6 months	1/10 of 1% of market value
over 6 months to 1 year	1/2 of 1% of market value
over 1 year to 3 years	1% of market value
over 3 years to 10 years	2% of market value
over 10 years	4% of market value

II. Bonds, debentures, treasury bills and other securities of or guaranteed by any Province of Canada and obligations of the International Bank of Reconstruction and Development, maturing (or called for redemption):

within 16 days	1/4 of 1% of market value
17 to 182 days	1/2 of 1% of market value
183 days to 1 year	3/4 of 1% of market value
over 1 year to 3 years	1 1/2% of market value
over 3 years to 10 years	3% of market value
over 10 years	5% of market value

III. Bonds, debentures or notes (not in default) of or guaranteed by any municipal corporation in Canada, maturing:

within 16 days	1/4 of 1% of market value
17 to 32 days	1/2 of 1% of market value
33 to 92 days	1% of market value
93 to 182 days	2% of market value
183 to 272 days	2 1/2% of market value
273 days to 1 year	3% of market value
over 1 year	5% of market value

IV. Other non-commercial bonds and debentures, (not in default) 10% of market value

V. Commercial and corporate bonds, debentures and notes (not in default) and non-negotiable and non-transferable trust company and mortgage loan company obligations, maturing:

within 1 year	4% of market value (a) and (b)
over 1 year to 3 years	5% of market value (a)
over 3 years to 10 years	7% of market value (a)
over 10 years	10% of market value (a)

(a) (i) if convertible and selling over par, apply the above rates on par value and add 50% of the excess of market value over par when convertible into securities acceptable for margin purposes or 100% of the excess of market value over par when convertible into securities not acceptable for margin purposes with a minimum addition to the above rates of 10% of par value. If convertible and selling at or below par, add 10% of par value to the quoted rates.

(ii) if selling at 50% of par value or less, the margin required is 50% of the market value.

(b) where such commercial bonds, debentures and notes are obligations of companies whose notes are acceptable notes as defined in Regulation 103 VI then the margin requirements in Regulation 103 VI shall apply.

VI. Acceptable commercial, corporate and finance company notes, and trust company and mortgage loan company obligations readily negotiable and transferable and maturing:

within 16 days	1/4 of 1% of market value
17 to 32 days	1/2 of 1% of market value
33 to 92 days	1% of market value
93 to 102 days	2% of market value
103 to 272 days	2 1/2% of market value
273 days to 1 year	3% of market value
over 1 year	apply rates for commercial and corporate bonds, debentures and notes

For the purposes of this Regulation, acceptable notes are notes issued by a company incorporated in Canada or in any Province of Canada and having a net worth of not less than $10,000,000 or guaranteed by a company having a net worth of not less than $10,000,000 where the borrower

EITHER:

A) Files annually under the applicable Provincial legislation a prospectus relating to its notes which have a term to maturity of one year or less and provides to Members acting as authorized agent(s) the following information in written form:

(1) Disclosure of limitation, if any, on the maximum principal amount of notes authorized to be outstanding at any one time.

(2) A reference to the bank lines of credit of the borrower or of its guarantor if a guarantee is required.

OR:

B) Provides to Members acting as authorized agent(s) an Information Circular or Memorandum which includes or is accompanied by the following:

(1) Recent audited financial statements of the borrower or of its guarantor if a guarantee is required;

(2) An extract from the borrower's General Borrowing By-law dealing with the borrower's corporate authorization to borrow;

(3) A true copy of a resolution of directors of the borrower certified by the borrower's Secretary, and stating in substance:

(i) the limitation, if any, on the maximum amount authorized to be borrowed by way of issue of notes;

(ii) those officers of the borrower company who may legally sign the notes by hand or by facsimile;

(iii) the denominations in which notes may be issued;

(4) Where notes are guaranteed, a certified copy of a resolution of directors of the guarantor company, authorizing the guarantee of such notes;

(5) A certificate of incumbency and facsimile signatures of the authorized signing officers of the borrower and its guarantor, if any;

(6) Specimen copies of the note or notes;

(7) A favourable opinion of counsel for the borrower regarding the incorporation, organization and corporate status of the borrower, its corporate capacity to issue the notes and the due authorization by it of the issuance of the notes;

(8) Where notes are guaranteed, a favourable opinion of counsel for the guarantor regarding the incorporation, organization and corporate status of the guarantor, its capacity to guarantee the notes and the due authorization, validity and effectiveness of its guarantee;

(9) A summary setting forth the following:

(i) a brief historical synopsis of the borrowing company and of its guarantor, if any;

(ii) purpose of the issue;

(iii) a reference to the bank lines of credit of the borrowing company or of its guarantor, if a guarantee is required;

Members may refer specific questions relating to the acceptability of notes under Regulation 103 VI. to the Director of Compliance or his staff.

VII. Bonds in default: 50% of market value

VIII. Income bonds which have paid in full interest at the stated rate for the two preceeding years as required by the related trust indenture which must specify that such interest be paid if earned:

Currently paying interest at the stated rate:

10% of market value

Not paying interest, or paying at less than the stated rate:

50% of market value

BANK PAPER

Deposit certificates, promissory notes or debentures issued by a Canadian chartered bank maturing:

within 32 days	1/4 of 1% of market value
33 to 92 days	1/2 of 1% of market value
93 to 102 days	1% of market value
103 to 272 days	1 1/2% of market value
273 days to 1 year	2% of market value
over 1 year	apply rates for commercial and corporate bonds, debentures and notes

ACCEPTABLE FOREIGN BANK AND FINANCE COMPANY PAPER

Deposit certificates or promissory notes issued by a foreign bank, finance company, or agencies of Canadian chartered banks in New York, maturing:

within 92 days	2% of market value
93 days to 1 year	3% of market value
over 1 year and up to 3 years	4% of market value

For the purposes of this category, acceptable paper consists of deposit certificates or promissory notes issued by a bank or finance company with a head office in the United States or the United Kingdom and having a net worth of not less than $25,000,000.

RULES GOVERNING THE MARGINING OF SECURITIES SUBJECT TO REPURCHASE AND OTHER AGREEMENTS:

(a) The obligation of a dealer to repurchase a security on a fixed date shall be margined from day one (i.e., the date of assuming a future liability with respect to the security) at the margin rate appropriate to the period between the date of the repurchase and the maturity date of the security.

(b) Securities sold with a dealer call feature (i.e. securities which the holder can put back to the dealer at any time prior to maturity on twenty-four hours notice or some other specified period of notice) are to be margined from day one at the margin rate appropriate for the term to maturity of the security.

(c) Securities sold with a dealer call feature that becomes exerciseable at any time after a fixed future date on giving specified notice (being securities which the holder may put back to the dealer at any time after such fixed future date on giving the specified notice) are to be margined from day one at the margin rate appropriate for the period between such fixed future date and the maturity date of the security.

(d) A security having an exerciseable borrower call feature is to be margined at the lesser of (1) the margin rate, as set out in Regulation 103, appropriate to the term of the security and (2) the spread between the end rate and the rate at which the dealer can put the security back to the borrower, subject to a minimum of ¼ of 1% margin.

(e) Securities sold with both a borrower call feature and a dealer call feature (or right of the holder to put the security back to the dealer for a total consideration representing a specified return) are to be margined as follows:

(i) if the dealer call feature is identical to the borrower call feature, no margin is applicable;

(ii) if the total consideration for which the holder may put the security back to the dealer is lower than the total consideration for which the dealer may put the security back to the borrower, no margin is applicable;

(iii) if the total consideration for which the holder may put the security back to the dealer ("dealer call feature") is above the total consideration for which the dealer may put the security back to the borrower ("borrower call feature"), apply the lesser of (1) the margin rate, as set out in Regulation 103, appropriate to the term of the security, and (2) the spread between the rate represented by the dealer call feature and the rate represented by the borrower call feature, subject to a minimum of ¼ of 1% margin.

BY ORDER OF THE NATIONAL EXECUTIVE COMMITTEE

J.A.M. MacFADZEAN

Secretary

APPENDIX "E"

EARNINGS OF NEW YORK STOCK EXCHANGE MEMBERS WHOSE SHARES ARE PUBLICLY TRADED
($000)

	First Boston	Merrill Lynch	(1) Donaldson Lufkin	Piper Jaffray	Bache	A.G. Edwards	(2) (3) C.B.W.L. H–S	(3) Reynolds
	Dec. 31	Dec.	Dec. 31	Dec. 31	Jan. 31	Feb. 28	June 30	Dec. 31
1964	2,497	21,015		172				
1965	3,234	32,174	1,554	428				
1966	4,707	44,898	2,541	564	6,417			2,909
1967	5,920	57,661	5,804	903	7,000	123	338	5,051
1968	7,714	49,139	6,828	1,303	10,439	741	1,348	5,468
1969	4,118	30,931	7,382	554	9,362	895	2,653	3,477
1970	11,500	40,727	2,457	834	(4,775)	(604)	546	3,791
1971					(2,448)	779	3,013	
1H 1970	2,709	10,067	605		(4,821)			1,409
1H 1971	6,503	26,348	3,501		8,232			5,817
2 Mos. to								
Apr. 30/70						(305)		
Apr. 30/71						500		
5 Mos. to								
1970				33				
1971				963				

NOTES: (1) *Ex difference in cost and fair value of long term investments. e.g. 1968 3,366 1969 (2,334)*
(2) *H – S Loss 1969 =$4,837; 7 Mos. 1970 =9,196; Contribution from NYSE on wind-up =$9,800,000*
(3) *In Registration*

APPENDIX "F"

PRICE PERFORMANCE OF SHARES OF LISTED NEW YORK STOCK EXCHANGE MEMBERS

	Donaldson Lufkin Jenrette	Piper Jaffray Hopwood	First Boston	Merrill Lynch
	Issued Apr. 9/70 at $15	July 28/71 at $19	June 15/34 at $6	June 23/71 at $28
1966			$\$24^{7}$ – 20^{1}	
1967			33 – 21^{5}	
1968			65^{4} – 26^{5}	
1969			94 – 43	
1970	16 – 5		65 – 28	
1971 to Oct. 1	18^{4} – 9^{3}	18^{3} – 17^{2}	115^{4} – 55	40 – 32^{7}
Current Oct. 1	11^{5} – 12	17^{2}	82^{4} – 84	35

APPENDIX "G"

DOMINANT POSITION OF TIME MAGAZINE AND READERS' DIGEST IN PERIODICALS MARKET

Year	Gross Advertising Revenue of all Members	Time and Readers' Digest	Percentage
1964	$ 18,226,000	$ 8,851,000	47.5
1969	$ 26,170,000	$ 14,641,000	56
1970	$ 27,505,000	$ 14,140,000	51.5

NOTE: The above statistics were provided by Magazine Advertising Bureau of Canada Inc., whose members publish the following periodicals:

A. English Language

Chatelaine
Miss Chatelaine
Maclean's
The Observer
Readers' Digest
Saturday Night
Time

B. French Language

Actualite
Chatelaine
Le Maclean
Selection Du Readers' Digest
T.V. Hebdo

APPENDIX "H"

CANADIAN LEGISLATION TO REGULATE FOREIGN OWNERSHIP

I. FEDERAL

1. Bank Act, R.S.C. 1970, Ch. B-1 Sections 52 to 57 inclusive and 75 (2) (g).

2. Broadcasting Act, R.S.C. 1970, Ch. B-11
   Section 27
   Order-In-Council P.C. 1969-2229
   (S.O.R. /69-590)
   See Also Canadian Radio-Television Commission
   Public Announcements
   – November 24, 1969
   – July 24, 1970
   – August 26, 1970.

3. Canadian & British Insurance Companies Act
   R.S.C. 1970, Ch. 1-15
   Sections 18 to 22 inclusive.

4. Income Tax Act, R.S.C. 1970 Ch. 1-5
   Section 13 (limitation on deduction of expense of advertising in non-Canadian newspapers and periodicals).

5. Loan Companies Act, R.S.C. 1970, Ch. L-12
   Sections 44 to 48 inclusive.

6. Trust Companies Act, R.S.C. 1970, Ch. T-16
   Sections 37 to 41 inclusive.

7. Canadian Oil And Gas Land Regulations
   (S.O.R. /61-253) made under the Territorial Lands Act, R.S.C. 1970, Ch. T-6 and the Public Lands Grants Act, R.S.C. 1970, Ch. P-29
   Section 55.

II. ONTARIO

1. The Loan and Trust Corporations Act, R.S.O. 1960, Ch. 222
   Sections 52a to 52f (New by 1970, Ch. 84).

2. The Paperback and Periodical Distributors Act, 1971, S.O. Ch. 82
   Sections 8 and 9.